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THE GOLD TANGLE

*A perfect and just weight shalt thou have :
a perfect and just measure shalt thou have :
that thy days may be long upon the land which
the Lord thy God giveth thee.*

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THE GOLD TANGLE AND THE WAY OUT

MEANING AND CAUSES OF THE GREAT INDUSTRIAL COLLAPSE

by

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INTRODUCTION

IN an era of the world's greatest productivity, occupying an Empire on which the sun never sets, enjoying the fruits of all the courage and self-sacrifice of generations that toiled and suffered, greatly adventured and greatly achieved and then passed into the unknown, we British people stand stricken, distressed, impoverished, losing our grip of Empire, our confidence gone, our credit depreciated, our industries paralysed, our people bewildered, our rulers distraught.

Yet we emerged victorious from the greatest war in history, our territory free from devastation, our Empire strengthened and consolidated, with fresh territory added, our capacity for common effort in a great cause nobly demonstrated, and our power to react to a great emergency tried and not found wanting.

Why then is Britain to-day in the throes of a crisis greater than any since the war? It is the purpose of this book to show the flaws in the national economy that have brought upon us a calamity only less than that of war, the sterilization of the lives of at least three millions

of our people and one-fourth of our industrial population. A citizen deprived of his livelihood is in little better case than a citizen deprived of his life, and although we have mitigated the worst consequences for the sufferers it has only been achieved by driving the evil still deeper and dragging down the strongest.

Has Britain the courage, the power, the will to take great decisions, to march boldly, to found her actions, not on the timid and wavering counsels of diverse committees and commissions, but on the less flattering warnings of her strongest critics at home and abroad, who see things in their broad, historical perspective, and know that no shifts or compromises can avail in a great emergency. The gift of leadership is still with us. The old spirit is not dead. We stand at the cross-roads. Which way shall we choose?

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THE GOLD TANGLE

CHAPTER I

BRITAIN'S CRISIS

THE storm which has burst upon the British people and which has brought them to a sudden sense of realities has been long impending. In all the demoralization and confusion that ensued at the end of the war, the keen observer could discern that the hopes, desires and good intentions of that time were a very shifting foundation on which to rebuild the economic structure of Great Britain. The vast war expenditure was taken as evidence of our enormous wealth, not as a dispersion of it. Despite a grave warning issued by those in the City who had probed the problem to its depth, that we could not return to pre-war conditions, the country, elated by victory, lavished its resources like a prodigal who has succeeded to a rich inheritance. The pound sterling in 1918 was not its pre-war equivalent. John Bull and Co. with a capital of not more than £16,000

millions, which represented the valuation of the Kingdom in 1914, had increased the claims of the shareholders to £24,000 millions, and could not distribute the same dividend on the larger capital unless the pound was valued at least a third less than before the war. Gold however had lost its value, discarded as it then was from nearly all the world's currencies and now held for the most part in New York ; and as long as that condition persisted we could build our castles in the air and hope to maintain our dividends.

Europe shared our faith in our impregnable strength. When all else seemed in a state of flux we remained like a rock in the middle of a raging torrent to which they could cling. Their funds were safe here and we were free to use them as we thought best.

So we set ourselves to cash victory at its full price. We enjoyed a short and hectic prosperity while a famine-stricken world clamoured to satisfy its hunger. In the spirit of Mr. Lloyd George's ambition that we should create a " land fit for heroes " we lightened the burden on our workers, stabilized a high wage-level, and piled up ever new expenditure on social services till the burden, capitalized, was equal to our huge national debt. To crown our work we cemented the whole to the gold standard.

Then gold came into its own and our troubles

began, for gold which we had reckoned cheap when all the currencies of Europe were living on paper, began to assert its claims when all the currencies of Europe, and the rest of the world too, followed our lead. The chase for gold began.

Our great and powerful neighbours across the Atlantic prized their gold. It had given them power to develop a state of prosperity greater than had ever been known in all history. The incredible had happened there, America could boast that there were enough motor vehicles within her boundaries to give all her people seating accommodation at one and the same time, and everything else was on the same scale. "If we part with our gold we part with our prosperity. We can live unto ourselves here." So ran the thought ; and the rest of the world was left to fend for itself. The experts at Geneva and elsewhere warned us that the gold standard could never endure the strain that would be put upon it, and that things would go from bad to worse as the years rolled on. Their warnings went unheeded. We in England bound ourselves to gold more rigidly still by decreeing that any expansion of credit should be dependent on our securing fresh supplies of the metal. Not a new note should be issued beyond the fixed fiduciary issue unless backed by gold or authorized by the Treasury and Parliament.

But the clouds were gathering ; £360 millions of gold wanted for debt service and sinking fund ; £300 millions or more for all our benevolent schemes, and the growing strain of unemployment eating up the millions week by week ; declining exports making it daily harder to get our gold supply ; and the whole of our national wealth pledged now, if gold should return to its pre-war level.

Then gold returned to its pre-war level—and beyond. Cotton and wheat, silver and copper at half their pre-war price, and everything in the same proportion or lower. Rubber at $2\frac{1}{2}d.$ per lb., sugar at $\frac{1}{2}d.$, linseed at $\frac{3}{4}d.$, sisal at $1\frac{1}{2}d.$, unheard-of prices and all far below the cost of production, and these the products to be offered in exchange for ours, with ours still 50 to 100 per cent higher than before the war. Value for value ! Where were our customers to obtain the funds to pay us even if they wanted to exchange on such terms ? To borrow was to invite bankruptcy. The realities came home with the loss of our trade.

Out of such a tangle none can emerge without a slow and patient unravelling of the knots. Let us clear the ground by reviewing what is actually involved in the processes of exchange, of production and distribution ; and with these fundamentals clearly in our minds we can rid ourselves of all the cross currents of pride and

sentiment, fond imaginings and vain prejudices that stand in the way of our grappling with realities.

But first let us say, that there are three courses open to every nation, as to every individual that finds itself in straits. It can use its credit, which means banking on the faith its friends have in its powers ; it can justify that faith with high productive effort ; and it can cut its expenditure till past luxuries become a mere memory. Such a discipline makes men into heroes, and that may be the “ land fit for heroes ” that we shall attain.

CHAPTER II

PRODUCTION AND DISTRIBUTION

i. HUMAN SOCIETY

THE modern nation represents an organization so varied in its activities, so diverse in its composition, that we who are its components rarely stop to think out the relationship that each of us bears to the whole and to our neighbours. Like bees we are born into a society that labours for common advantage with a common feeling of solidarity, although each of us is conscious of personal inclinations, ambitions, sympathies or antipathies that yet do not detract from our social instincts.

This organization, in some ways so perfect and so productive, seems in other ways singularly defective and haphazard. So unequal is it in its rewards, hardships and compulsions that men from age to age have been tempted to redesign it on a better plan. The Republic of Plato, the Utopia of Sir Thomas More, the Phalanstère of Charles Fourier, and many that have succeeded these have conceived a new order. We are all, indeed, striving continually to evolve

that happy era which will make all men contented. Of the reasons why it never arrives we may have more to say later, but we cannot even begin to improve the lot of humanity until we know the vital laws that govern life in general, and economic life in particular. It is largely our ignorance of these that has brought such catastrophe to the whole world and has led England, a pivotal nation, into one of the most disastrous periods of her economic history. Russia, too, has set herself the gigantic experiment of destroying the old order, seeking to replace it with something startlingly new, and the world watches the result with apprehension, for she explores virgin territory ; and were her purpose to succeed it might transform the economic structure of the whole world. But that movement like all others must conform with the basic facts of human nature.

If we look at an ant-heap we are struck by the overflowing activity of individuals and masses applied to maintain the existence of the community, and we who, god-like, survey their struggle realize how blindly they are groping. So, too, we of a higher order blindly groping in darkness are prone to exhaust ourselves in attempting impossible things, in achieving changes that can never stand or that may bring disaster to the inventors. It is our business to show why so much of the effort to improve our lot

has reacted against ourselves ; to discuss how far our actions have diverged from the paths of sanity, and to suggest how we can direct our steps to a new advance which may rescue us from our present peril.

2. LABOUR

The human beehive which we call our social order normally provides the two great essentials of existence ; the food that sustains us and the activity of mind and body that converts our sustenance into those useful services that keep us in health and prevent our minds and bodies from degenerating. Labour is too often looked upon as the penalty of existence. “By the sweat of thy brow shalt thou earn thy bread,” is from this point of view the most desirable commandment that has been given us as a means for self-development. But it is a privilege also to be fought for, and so it happens that nearly every nation instinctively prefers to do for itself what might be done better by its neighbours, and endeavours as far as possible to render itself independent of their products. The lesson of history has been driven home. Older nations have disappeared just because they became too dependent on the labour of others. Slave labour undermined the civilization of the ancients and made them, before many generations had passed, a prey to the

sterner and less luxurious peoples whom they had regarded as barbarians.

Work, then, is a privilege to be sought for and not merely because work and maintenance are complementary to one another (not substitutes for each other, as a popular cry would have them), but because the highest pleasure comes from the creative use of our faculties ; indeed, a very great deal of the productive effort of the human race is attributable to men who have never thought of, or looked for, reward. Napier the inventor of logarithms, Darwin the discoverer of evolution, and Gibbon the historian, filled laborious days, not for their own benefit, but for the good of the world, and their own good pleasure.

3. ORGANIZATION

The mere willingness to work, however, is not enough even in the most primitive society. There must be some degree of organization among those who are ready to serve, each man filling the special function in which he can develop his powers or prowess to the highest advantage ; and so we need leaders or organizers. In its earlier form we have tribal chiefs and petty kings, but as society becomes more highly organized the political and the economic functions diverge, the one demanding rulers, councils and parliaments ; the other, leaders

of industry and men of enterprise. Frequently the qualities that are ideal for one are ideal for both. Leadership does not belong to the masses ; it calls for innate qualities and special training : it may be arrogated without any conscious selection on the part of those who are led. “Ye have not chosen me but I have chosen you,” remains typical of all great leadership.

4. SAVINGS

But the needs of an organized society do not end here. No progress is possible unless there are reserves, supplies of food or material beyond the daily needs of the worker, which can be made available for the building up of a new generation. Every new venture, too, makes demands on the reserves until it, too, becomes productive. There must, therefore, be saving. Some must be willing to renounce immediate enjoyment for the hope of future reward. Savings create capital, but capital is not savings : it is savings “invested,” that is to say, adventured, put to risk, so that their use may bring mankind up to a higher range of human endeavour than was formerly within his reach.

5. ENTERPRISE

Human life is itself a great adventure which begins from the moment we are born. We

train for our special function in life totally unaware whether we shall ever be called upon to fulfil it. The farmer who scatters his seed on the soil has no guarantee that the vicissitudes of the climate will ever bring it to fruition : and when he harvests his crop he has no certainty that it will be wanted. He may find an over-abundant supply bringing him less return than his expenditure, as is so frequent in these times. At every step of his progress he is risking his capital. No new industry was ever started that did not give its founder deep anxiety, laborious days and grave doubts, as the prospect of failure threatens him time and again. For one new scheme that succeeds a dozen may fail and a hundred may never see the light of day. But the spirit that dares and aspires is the most vital necessity in the progress of all nations. Even if we hold like some that the adventurous band which defeated Harold at Hastings were scarcely better than unlicensed marauders, we are bound to recognize that, little though they recked it, they changed the course of history. Those Normans inherited their grit and daring from their Norse ancestry, and passed it down the ages to our own days. The same spirit, innate in our islanders, appears again and again in our world roamings and in our wide-flung Empire ; and leaves its traces where the bones of our

race lie whether by the inhospitable poles or on the icy breast of Everest. These ancestral qualities are our proud heritage, and in turn those of our American cousins, whose ceaseless energy and daring have contributed so largely to the creation of improved conditions of life for the whole world.

6. THE STATE

Labour, organization, saving, enterprise ; here are the main forces that minister to production, but if we include the organization of business as properly belonging to the sphere of enterprise, we can define Labour, Saving and Enterprise as the trinity of production, leaving still to consider the function that is performed by the State, that greater organization that covers the whole community.

We have seen throughout the ages every form of government built up, family, patriarchal, tribal, regal, national and imperial, but the object has always been to provide security for the works of peace. Amid all the disorganization and misery of the Middle Ages that followed the break-up of the Roman Empire, we see the gradual consolidation that began under the protection of castle walls and spread slowly till, with a higher development of government, the functions of nobility had degenerated from service into privilege, and revolution, as in France,

swept away the last remnants of a feudal system. Our own system has evolved, not smoothly indeed, but with less world clamour ; and we have arrived at the stage where something more than protection is claimed by the subject. In effect, the State can only live at any time through the services of its citizens, and at every stage of history we find the health and prosperity of each nation dependent on a just apportionment between the activities of the State in peace or in war, and the claims of the individual for freedom to pursue his avocations with the least possible hindrance.

7. APPORTIONMENT

The question of apportionment of the product amongst these agencies is so vital to production that any error or disturbance to the just equilibrium of the parts we have considered may endanger the whole mechanism of society. But what is the just equilibrium ? That question is never settled. Each of us interprets it in his own way. In no age has the lot of the worker been more fully considered than now, especially in our own country, yet no one can say that the results are as satisfactory as had been anticipated, and if we are to seek for a reason it is this : if any one component of production gains at the expense of another, the productivity of all will suffer. If we take for example the question

of savings, the inducement to save money rather than to spend it depends entirely on two things —the return that savings may yield and the security of the conditions including the stability of the currency in which they are held. There will be less willingness to save in a depreciating currency as was exemplified in Germany on the eve of her defeat and after. But under normal conditions we may assume that there is a definite coefficient of saving which will induce sufficient accumulation to serve the needs of the community ; and the more we tax savings or the more we diminish security the higher will that coefficient rise. In other words, we shall have to pay more to induce people to save.

It is more difficult to assess what is the just return for enterprise or risk-taking, but of one thing we may be assured, the return must cover all losses where reasonable care and skill is exercised. Thus, in an enterprise where the chances of success are as 1 in 3, the successful venture may be expected to receive as its reward at least three times the return of a perfectly safe investment. We see this exemplified in a less legitimate field of human venture, the sweepstake. The entrant if he wins expects to gain, approximately, at least as much as the rest of the competitors lose.

We must not forget also the case of the citizen who sinks his surplus in producing those valuable

human elements the highly trained professions : doctors, writers, engineers, lawyers, artists, musicians, or any of the numerous specialists on whom so much depends in the organization of society. This is as definitely an investment of capital as is the building or equipment of a factory, and this too carries considerable risk owing to the vicissitudes of life and fortune, and has to be rewarded accordingly, even if the original investor, the parent or guardian, does not live to see his expenditure reap its due return. Training of this kind is costly and the results are slow to accrue.

There remains to consider the claims of government. In so far as governmental activities are a real contribution to security or to efficiency, as, for instance, in the defence of the realm from war or disease, by creating improved technical ability in its workers, or by providing stable conditions for industry, to that degree the contribution of government emerges easily and naturally out of the increased productivity of its people. But the moment this point of view is lost sight of, danger arises.

8. COST OF PRODUCTION

Behind all these processes one testing principle governs all : How will the expenditure affect the cost of production ? And this is true even where the State itself is spending the money.

We can conceive a state enlarging its sphere of action so widely that it undertakes all the processes of industry, takes the reward to itself and has one uniform standard of remuneration for all its workers, trained or untrained. In theory at least that is the objective of the Soviet Republic. A principle not unlike this prevails in the world of Association football, where the reward granted to professionals does not prevent the clubs from profiting by transfer fees ; but it is to be feared that in any other sphere of action it would be looked upon as inconsistent with the rights of the individual.

It is certain that private initiative in industry will be hard to foster without the incentive of personal gain.

9. SELECTION

There remains a subsidiary principle at work in the valuation of human activities which is only indirectly related to cost of production and which can be illustrated in this way. A market gardener having grown his strawberries finds a great variation in their size and quality. He selects the good from the indifferent, selling the former at a higher price than he would get for the average and the inferior at a lower price, while he will discard completely a small proportion as unfit for sale. Not only must the cost of selection be included in the sale

price but the price of the superior must compensate the price of the inferior, including loss through rejection. The same process is continually at work in human society. Of one doctor who attains to rank and fame there may be a thousand who never rise above the rôle of the humble practitioner whose reward barely represents a return for his years of preparation. There may be some even who never "arrive." The public makes the selection. However unfair or fortuitous that selection may be he cannot complain. The same process goes on in every shop or store ; it is a contest between the freedom of the public to choose and the endeavours of the producer to attract their choice. It is this that determines the difference between the prices for fashionable and unfashionable goods, between the "season's" prices and the "sale" prices. It is a freedom the public is never likely to barter even for all the promises of a socialist paradise where State-run stores shall provide us with the garments we *ought* to wear as decent, respectable and law-abiding citizens. Freedom and inequality are unfortunately inseparable companions, and without these there can be no progress, since it is the bait of high reward that determines most men in their choice of careers. The public gains by having a wide group to select from, the individual benefits by the contest for selection. Nature confers her

blessing on a process which conforms with one of the basic laws of existence.

10. RENT

A more elusive factor has still to be dealt with, which figures in every man's cost of production but is only indirectly related to service. The economist's conception of rent does not mean the reward the landlord receives for buildings or improvements to the land, but that intangible quality called value, which arises from the convenience offered by a site through its position or its natural resources. Is rent a factor in production? Not exactly, since rent under this definition merely adjusts the cost of production of the more productive area to that of the less productive area. But this introduces us to a new point of view.

Every increase in the demand for a product of the land must call a new area into cultivation. The new area must of necessity be less productive or it would have been cultivated before. Thus arises the conception of the marginal producer. The price for all must be raised till the marginal producer can live. The added profit of all other producers is nothing more than rent as above defined, whether it goes to the producer himself or to his landlord. All this expresses the practical law of life that, as population expands, the pressure of existence increases. In

effect we have to accept a higher cost of production as a whole. Every one will be a little worse off except the landlord, who will take a larger toll and consume for himself or others a larger share of the total. Pressure of population on the land thus tends not merely to engage additional labour on the land, but to redistribute wealth and by so doing calls new services into being.

This is important to remember because it helps to explain how pressure of population strengthened the power of the barons of old and allowed so much of the population of Europe in the Middle Ages to be spared for war ; and why, equally, in times of peace new trades were brought into being, the arts fostered, and the progress of civilization spurred on.

Since rent, however, in its purest sense, as the economic handicap that brings all competitors to a common level, represents no direct service, it has inspired the tenets of a large school who hold that, being really a product of the community as a whole, rent should not be the subject of private dealing or control. The strongest argument in favour of this view is that as the pressure on the community increases the benefit to the holder of land increases also, and with the increase of his wealth he may actually be able to withdraw more land from cultivation and, where the pressure is already

severe, convert it to less useful purposes such as sport. The French Revolution has, indeed, been traced to this cause, although it may be described in more general terms as the reaction from an outworn feudal system of which our land tenure still has survivals.

Much may be said on either side as to the merits or demerits of personal ownership. It is difficult to discriminate between improvements in value due to good judgment, careful administration or foresight and those brought about by the accident of fortune: but this is equally true of business in general, and we may therefore leave the question of rent as having no direct bearing in a discussion on the motive power of production.

II. THE BALANCE OF FORCES

We have thus briefly summarized the factors that go to form the social economic contract which leads to production and to which we are all a party. Deeply rooted in the human mind is the principle of value for value which is summarized in the old saying, "Nothing for nothing and precious little for sixpence." It implies that there can be no reward without service; but each member of society is inclined to view his contribution as of outstanding importance, so that we may often hear a street orator declare that, as all things of value are

the product of human labour, labour only is entitled to the reward. There is thus a never-ending conflict between all parties to secure what they consider fair play, and how that conflict is decided depends on the creation or destruction of those essential elements that go to make the welfare of the whole. At the beginning of the industrial era a century ago, the very progress of invention and industry was injurious to the interests of the workers who were poorly organized and had little or no protection from the instability of conditions caused by such rapid changes. Their needs were little considered, and to that we owe the degrading conditions, the long hours of work, the wretched homes that accompanied an age of unexampled progress and wealth. Our fathers with all their piety lived under a realist philosophy that accepted these things as being heaven ordained. But it could not remain so. The race itself was suffering injury and little by little the Trade Union movement fought its way forward, determined to secure fair play for the worker. The more humane employers realized that the Trade Unions were working for the benefit of all, by putting a curb on the greed of individual employers. Their action stabilized fair conditions for all. It secured the standard of living that made for healthy and happy workers, and under such conditions better work could be produced.

But the Trade Unions only covered part of the ground and by that very fact the pressure on the unorganized portion of the community tended to increase, in spite of legislation to control it. The realization of this is responsible for the evolution of the Trade Board, and we shall consider later how far this movement has exceeded the purpose of its original founders.

The early economists looked to find the remedy for most ills by leaving the forces of nature to work out their own salvation. Theirs was a kind of economic fatalism that regarded everything as for the best. Doubtless forest law may ultimately prove who is the strongest, the fleetest or the cleverest, and thus establish a balance of forces quite apart from the ethical side, but such a method does not necessarily lead to a higher evolution, and in the conflict of modern commerce among the nations it might even leave us as vulnerable as the lion or the rhinoceros before the advance of civilization. Britain has chosen rather to lead the world to better purpose and to regulate her own evolution, but in doing so we are apt to run into fresh dangers. We may place an undue burden on the other factors of production. Abstinence must have its reward, or the earnings needed to develop industry will cease to be available. If the profits of enterprise fall below a remunerative level the incentive to create new ventures or even

to maintain the older ones disappears ; unemployment springs up, and even savings are discouraged since they find no productive outlet. We see then that the most vital problem of economics is the just distribution of the product of society. The whole efficiency of the machine hinges upon that. The world to-day is suffering not from lack of production but from ill-balanced distribution, and well-meaning socialists who have tried to remedy this state of affairs on lines of their own have seen, as in England and Australia, the downfall of their benevolent schemes for reasons that demand analysis.

But before we can proceed intelligently with this investigation we must measure the forces with which we are dealing. We are thus at the outset confronted with this cardinal fact : The basis of every contract, of every transaction in civilized life, whether public or private, is governed by the standard of measurement of values. If that standard varies, all estimates are falsified, and all endeavours to establish just relations are stultified. This fact inescapably drives us to consider at the outset the vital part that money plays in the whole organization of civilization as to-day constituted.

CHAPTER III

MONEY

1. NATURE OF MONEY

MONEY may be described as the vehicle by which the product of society is distributed. It is an evolution from the earlier barter which the schoolboy still practises in his dealings with his fellows. We have still relics of an earlier age in Africa where the cattle, which gave us the Roman name for money, "pecunia," remain the currency in which the native bargains for his wife or assesses his wealth. Such crude and primitive methods, however, could not long endure before the convenience of coins cut from bars of precious metal ; and society could be said to be definitely organized as a trading community when the responsibility for the coinage was assumed by the rulers whose "image and superscription" was stamped on the coin.

That indeed is the first recognition that the King who administers justice to his subjects is responsible also for the maintenance of just weights and measures ; and the provision of a

just measure of value was of no small consequence to his subjects. Silver, gold, copper and bronze now assumed the burden of supplying the world's monetary needs, a stage of progress which survives into modern times. But with the advance of civilization a new conception of money arises. From being merely a store of value, it becomes a title to value which need not necessarily be of metal. Like any other legal document it may be of paper, just like a bill of lading or a warrant for goods on deposit. The bank-note may, indeed, be the equivalent of a metal warrant. Under Peel's Bank Act of 1844 the Bank of England £5 note was to all intents and purposes a warrant for a fixed quantity of gold. No notes could be issued by the Bank unless backed by gold, if we except the £11 million based on Government debt which remains as a kind of rudimentary appendix in the Bank's balance sheet.

Notes may be issued nevertheless by banks and governments in excess of their metallic backing, and the promise holds good to honour them for their value in the metal for which they stand. In these cases the duty of the bank or government is to maintain *parity* with the metal by *managing* the issue so that it will at all times purchase the requisite amount of gold, or whatever the note stands for. This is the true "fiduciary issue." The confidence of the public is

maintained by the continuous offer to pay gold against notes, and only the simultaneous presentation of the whole issue could cause any disturbance to its value. It is possible, of course, to issue inconvertible notes and even to manage their issue so as to conform with the standard chosen. Their value in that case depends purely on the limitation of the issue. Much light was thrown on these questions by a recent important case in the Law Courts.

2. MONEY AS A TITLE OF VALUE

But if we are to accept the broader definition that money in the modern sense is a title or claim on society, whether it consists of gold, silver, paper or so-called token issues (i.e. currency circulating for more than its real value), then we at once perceive that we must widen our horizon. Claims on society are created in many other ways than by the issue of banknotes. We may hold purchasing power in the form of a bank account. We write a cheque transferring part of that purchasing power to our neighbour, and in so doing are transferring money to him just as truly as if we paid him notes or coin. We may give our neighbour a promise to pay in three months' time which he can treat as cash by negotiating it with his bank at a discount, or we may even surrender a holding of consols or other fixed interest bearing

stock. But in all these transactions there is one test by which we distinguish which is money and which is not. Is the purchasing power immediately transferable without gain or loss to either party? These promises to pay, whether they take the form of cheques, notes or coin, give the holder no inducement to retain them. They carry no interest. They are instantly liquidable. The impetus to circulate them is at its maximum; or expressed in another way, their velocity of circulation cannot be exceeded unless, as happened in Germany during the great inflation, the currency loses value so rapidly that it becomes dangerous to hold it even for an hour.

It follows that a bank deposit or current account carrying no interest is money within this definition, but that money transferred to a deposit account and receiving interest, however low, is merely potential money. Money deposited in a savings bank is similarly not intended to circulate and, until it does circulate, has lost this essential quality that makes it currency or the equivalent of currency, or to use another word, "circulating medium."

The bill of exchange, if bearing responsible signatures, has the virtue of ready convertibility and in it we find epitomized the whole story of money in commerce. The bill itself represents the transfer of goods from producer to consumer. It allows time for the conversion

and merchanting of the product. It calls into being the money which will effect the exchange, and thus links money directly with its function of regulating demand to supply.

3. THE BANK RATE AND "VELOCITY OF CIRCULATION"

The bill of exchange brings into relief the inherent connection between the discount rate for bills and the "velocity of circulation." It is obvious that velocity of circulation applies not only to the medium of exchange but to the goods exchanged. The more we approach the maximum velocity of circulation by reducing the return on all forms of paper held, the more do we increase the number or volume of exchanges that take place. Lower money rates therefore directly stimulate trade, but they also stimulate it indirectly. It becomes profitable to buy gilt-edged securities and to borrow a proportion of their value on the security of that holding. Money held on deposit and yielding an inadequate return can now be released, and is released if public confidence is normal. Stocks change hands at a higher price and the profits become available for new investment. As the yield on the safer securities falls, the desire to obtain a higher return drives investors into new enterprises. The demand increases for what are called producers' goods;

such as building materials, railway equipment, ships, docks and manufacturing plant. Production increases, and out of production the investor looks to secure his return. Expansion continues until the yield of enterprise falls below its fair rate. We reach the point when profits, and therefore savings, cannot keep pace with the original impetus and the cycle ends with an increasing demand for money and higher money rates. The Cunliffe Report described faithfully in 1918 the effect of a rise in the Bank rate.

“The raising of the Bank’s discount rate and the steps taken to make it effective in the market necessarily led to a general rise of interest rates and a restriction of credit. New enterprises were therefore postponed and the demand for constructional materials and other capital goods was lessened. The consequent slackening of employment also diminished the demand for consumable goods, while holders of stocks of commodities carried largely with borrowed money, being confronted with an increase of interest charges, if not with actual difficulty in renewing loans and with the prospect of falling prices, tended to press their goods on a weak market.”

The Bank rate is thus the instrument of control by which the Bank of England “manages” the currency system and maintains parity between

the national price level and gold. If prices rise unduly imports of goods are stimulated, and the Bank is called upon to restrain an outflow of gold to pay for them. Conversely, if prices fall unduly, exports are stimulated and unwanted gold tends to accumulate, calling for action by the Bank to encourage an outflow by offering greater facilities to the borrower. The movement of gold guides their operations as the movement of the mercury in a clinical thermometer guides the physician.

It will be seen how important are the operations by which the productive power of the nation is controlled, and how powerful is the influence of those changes in the value of money which determine the price we have to pay for the hire of it. How could it be otherwise? The discount rate which we call the Bank rate does in effect govern the distribution of the product of society as between the various agents of production, workpeople, savers, organizers, the State. A variation of one-half per cent seems small, but must be reckoned by its influence on a turnover of £3,000 to £4,000 millions a year. Compare the potency of a rise in the cost of building of, say, 50 per cent, not merely on the new houses built but on all the existing stock of houses, and then consider that no new houses can be built, no new enterprises started without new

money, and a rise of 50 per cent in the Bank rate even though it only makes the difference between 3 per cent and $4\frac{1}{2}$ per cent, has a similar significance. It operates throughout the whole mass of stock exchange securities governing their yield ; it represses or accelerates the pace of general trade. It creates or retards employment. The management of the credit machine is therefore of vital importance to us all ; and the means by which that control is exercised call for some little study.

CHAPTER IV

THE BANKING SYSTEM

I. ORIGIN

OUR banking system has evolved like our constitution apparently without any conscious direction ; but certain landmarks stand out conspicuously. Lombard Street still recalls the exchange bankers who transferred their operations from Italy and dealt in the currency of the various states of Europe. The Bank of England dates its origin from certain privileges granted by the State in return for a loan of £1,500,000 made about 1694 to finance the war against France. Three years later these privileges were converted into a monopoly of the note issue and this was strengthened by a subsequent Act of 1708, which barred the way to the formation of joint-stock banks and resulted in such a deplorable insufficiency of money that the Bank of England was itself, in 1797, compelled to stop payment. How severe was the restriction can be judged from the Act above mentioned :

“ During the continuance of the Corporation of the Governor and the Company of the Bank

of England, it shall not be lawful for any body politic or corporate whatsoever, created or to be created (other than the said Governor and Company of the Bank of England), or for any other parties whatsoever, united or to be united, in covenants or partnership, exceeding the number of six persons, in that part of Great Britain called England, to borrow, owe or take up any sum or sums of money on their bills, notes payable on demand, or at any less time than six months from the borrowing thereof."

Not until 1829 was the monopoly broken through the discovery that banking could be conducted without the issue of notes by a system of deposits and cheques. The formation of joint-stock banks quickly followed and revolutionized British banking, for the right of note issue was now seen to be a matter of secondary importance. The monopoly of note issue, with a few minor exceptions, remained with the Bank of England, but the country had outgrown it. A very important consequence followed. As the right of note issues remained with the Bank of England, the joint-stock banks naturally made that institution the Bankers' Bank. The "Central Bank" was evolved for the first time in history and the Bank Act of 1844 confirmed its office by placing on that body the main responsibility for honouring its notes in gold. So rigid indeed were the restrictions imposed

upon the Bank that had the country really depended on note issues for the development of its trade, all further progress would have been arrested. As it was, crisis followed crisis in 1847, 1857 and 1866, but the joint-stock banks were now developing their system and extending their power. As time went on the Clearing House was evolved to undertake the exchange of cheques between the principal banks ; and the magnitude of its operations is such that it now handles an annual turnover in cheques of £40,000 millions, an amount one hundred times greater than our issue of notes.

The Great War liberated the Bank of England from the control of the note issue, and the Treasury Note came into being with Government sanction and backing ; but this change did not displace the Bank from the position of authority it held as the Bankers' Bank, and its powers were fully restored in 1928 with the withdrawal of the currency note and the restoration of the Bank of England note as the currency of the nation.

2. THE CENTRAL BANK

The Bank of England thus occupies much the same position as the leader of an orchestra, and the orchestra accepts its leadership because to do otherwise would be fatal to its own existence. Yet to each individual member of the

system a wide discretion is left. By granting loans each member, by which we mean the joint-stock banks, can as effectively extend credit and increase his trade as if he were to issue his own notes. An advance of £1,000 to any customer enables that customer to draw cheques to the same amount in favour of other depositors, and the account of the latter will instantly respond by showing an equivalent increase of deposits. This process cannot, of course, continue indefinitely. No bank can safely extend its credit operations beyond ten times its holdings of cash.

It is interesting to see the form in which the ten Clearing Banks hold their deposits. In August, 1931, they had—

Deposits to the value of £1,745 millions.	£ million.
Against these they held investments for	302
Bills discounted	264
Advances to customers and other accounts	908
Money at call and short notice	113
Cash (coin, currency notes and deposits at Bank of England)	180
	<hr/>
	£1,767

Percentage of cash to deposits, 10.3.

As cash means Bank of England notes or deposits with the Bank, which are both regarded as equal to gold, any increase in the note issue that finds its way into the joint-stock banks may thus admit of an expansion of credit for the service of the public which takes the form of

deposits of nearly ten times the amount. An increase in Bankers' deposits with the Bank of England serves the same purpose, as a foundation for credit to be made available to the public.

The Bank of England balance sheet explains the position. It is divided into two departments in accordance with the Act of 1844 :

BANK OF ENGLAND BALANCE SHEET. 24TH JULY, 1931

Issue Department

	£ Thousands.	£ Thousands.	
Notes Issued :			
In circulation . . .	356,098	Government Debt	11,015
In banking department	52,676	Other Government securities	233,267
	<hr/>	Other securities	11,626
		Silver	4,092
		<hr/>	260,000
		Gold Coin Bullion	148,774
	<hr/>		<hr/>
	<u>£408,774</u>	<u>408,774</u>	

Banking Department

	£ Thousands.	£ Thousands.	
Capital	14,553	Government securities	34,376
Rest (in reserve) . . .	3,526	Discounts and advances	7,099
Public Deposits (including Government)	16,373	Securities	31,977
Bankers' Deposits . . .	60,180	Notes	52,675
Other Deposits . . .	32,765	Gold and silver coin	1,271
Seven day and other bills	1	<hr/>	<hr/>
	<hr/>	<hr/>	
	<u>127,398</u>	<u>127,398</u>	

The Fiduciary Issue in the Issue Department, as will be seen above, is fixed at £260

millions, but this figure has since been raised with Treasury sanction to £275 millions. But normally no expansion can take place in the Issue Department that is not backed with an actual increase in the stock of gold. Of the notes issued, £356 millions pass into the hands of the public or the joint-stock banks. The remainder, £52 millions, serve as the equivalent of gold for the Banking Department. Let us assume now that a demand for increased circulation comes from the general public irrespective of the needs of the banks. In that case unless the Bank of England can secure more gold the bankers must go short. True, the bankers have the alternative of increasing their deposits with the Banking Department, but in that case they depend on an expansion of the notes held by that department which figure in the balance sheet at £52 millions, and it must be obvious that any expansion in this direction is precluded by the very same cause that prevented the banks from securing their requirements from the Issue Department direct. Thus the demand cannot be satisfied failing the arrival of fresh supplies of gold.

The only elasticity in the system therefore depends on the "Ratio" between "Notes and gold" held in the Banking Department and the Volume of deposits, which includes the deposits of Government departments, bankers and

the outside public. As it is the practice of the Bank of England to hold its deposits covered by about 50 per cent of notes or gold, the hopes of expanding in this direction are drastically circumscribed, for the banks have no control over the demands of the Government or even of those members of the public who bank independently with the Bank of England. In fact if these latter depositors are eliminated from the scene as not being strictly pertinent to a study of our central banking system and more likely to hinder than to help any expansion of credit, the bankers, with their £60 million deposits against a holding of £52 million ranking as gold, are in little better case for expanding credit to their customers than if they applied direct to the Issue Department for notes based on gold.

3. THE LINK WITH GOLD

It follows that the only means the nation has of expanding credit for the expanding needs of commerce or population is that of securing gold. On the basis of that gold the joint-stock banks can then meet the requirements of trade to the extent of about £10 for each £1 of gold that the Bank of England can secure.

It is true that the Bank of England can apply to the Treasury for an increase of the fiduciary issue ; but this procedure is such an advertise-

ment of weakness that it can only be expected to be adopted in circumstances of the greatest urgency, as during the credit crisis through which we have just passed.

Thus in spite of the noteworthy progress we have made in our understanding of banking ; in spite of our ingenuity in circumventing the evil consequences of the foolish legislation of 1708 and 1844, we are once again in the grip of a cast-iron system of banking so rigid and cramping that, relative to the magnitude of our financial interests in the world, our former follies seem mere childish errors. Not only have we accepted gold as the basis of our currency, but we have created a system which almost completely eliminates all elasticity. Nor is the gold we hold available to regulate our exchange abroad. The larger proportion must be held as cover for the note issue in the hands of the public, although the public are not entitled to the use of gold coin. Only a relatively small proportion of gold can therefore function in the sense in which we have described money, i.e. as circulating medium available for the settlement of international debt. The Macmillan Committee have called attention to this extraordinary error.

In spite of these defects, however, the evolution of our banking system, like that of the British Constitution, has created for the world a

model which has served for most of the Central Banking Systems that have been set up of recent years. Unfortunately a feature of many of these reproductions is that they embody its defects as well as its virtues. The primary need of regarding gold as having a useful function only when it circulates is too often lost sight of; enormous stocks become sterilized under the name of "statutory reserves" or even far beyond statutory requirements, regardless of the criticism that it is not according to the rules of the gold standard and is an injury to their neighbours on the part of those who practise it.

Other nations have tried to evolve features of our system like the money market, which deals in bills and is therefore an important factor in the control exercised, but so far they have never quite attained the harmonious co-ordination of all parts that seems natural to our own system. The conception of the functions of a Central Bankers' Bank has now been carried a stage further by the creation of the Bank of International Settlements and, should this become, as intended, the "Central Bankers' Bank," it will greatly simplify those international transfers of credit which put such pressure on the market for gold. We may even look to this institution at some future date to provide us with the nucleus for achieving the next great advance in Banking Science—the creation of an

international standard of value that will establish fair dealing in the settlement of their debts, as between all nations.

The most valuable principles that our banking system has proved are :

1. That the control of values can be placed on as firm a basis as the judiciary and can be made as independent of political interference.
2. That the business community through its own chosen representatives is the best medium for the administration of the banking machine in precisely the same sense and for the same reason that the legal profession is best fitted to provide for the administration of justice. Common interest demands fair administration.
3. That values can be controlled to any chosen standard, whether gold, silver or such other standard as may be devised.
4. That the purpose of the control is not to convert *all* demands that can be made upon it into tenders of metal which would be the *reductio ad absurdum* of the whole system and manifestly unfair to those who did not join in the scramble ; but to maintain parity with the chosen standard under conditions of free circulation. As we have shown, the index of parity in the case of gold is to be found in the movement of the metal.

CHAPTER V

THE GOLD STANDARD

I. GOLD AS MASTER

WE must now turn to consider how gold has served us as a basis of measurement for values.

It was a momentous day for Britain when in 1817, with peace assured by the internment of Napoleon, she decided to base her currency on gold and to discard silver as a tender for more than £2. The relation between gold and silver fixed by Sir Isaac Newton a century before had failed to stand the test of time. The demand from the Continent was all for silver, which was then the standard of values, and stocks of gold were accumulating in such quantities as to favour such a change. We stood alone. Since those with whom we traded relied on silver and did not want our gold they never pressed us for it, and we were free to develop our manufactures in order to satisfy the needs of our customers abroad.

We had a clean run till the Franco-Prussian War of 1870 raised Germany to a new pinnacle

of power, and the large war indemnity extracted from France decided the former to adopt the gold standard. We had set a new fashion and its influence spread. The pressure on gold gradually increased as other nations one by one found that the old bimetallic regime of $15\frac{1}{2} : 1$ could no longer be maintained. The United States endeavoured to stem the tide by heavy purchases of silver under the Sherman Act, but finally abandoned the attempt and accepted gold without alternative. We too linked the Indian rupee to gold by stopping the free mintage of silver and fixing a definite ratio between the rupee and the £ sterling. Other nations quickly followed. It was fortunate at this stage of events that a new process was discovered for the extraction of gold, the so-called "cyanide process," which led to a notable reduction in the cost of production and which enabled grades of ore that were formerly unpayable to become profitable. Dating from 1895-6 there followed the rapid exploitation of the Transvaal, an area which now supplies about half the world's production of gold, and it is not without significance that the year 1896 marked a turning-point in the purchasing power of that metal.

The gold standard had now achieved supremacy over all others, but it was not till the Great War broke out and the needs of the belligerents released huge stocks of gold that

the instability of the standard came to light. We ourselves were immediately forced to abandon any attempt to finance the war on a gold basis, although America, whither most of the world's gold had drifted, was able to retain the connection ; and it was not until 1925 that our ambition was once again achieved, "to look the dollar in the face." In that year we reverted to the gold standard and we shall now examine how this metal has served the nation's needs.

2. FLUCTUATIONS OF GOLD

If gold is accepted as the measure of values it is obvious that the value of gold itself must be measured by its relation to other values. We have a ready weapon for that measurement in the principal index numbers. The *Statist* which adopted Sauerbeck's index number (itself linked up with a still older index, Jevons) gives us the longest record we can hope to attain of the movements of the 45 principal wholesale commodities, dating from 1809. As we are considering here the value of gold as an international counter we may, as the *Statist* does, accept the year 1871, when Germany acceded to the gold standard, as a basis for all calculations. This figure as it happens coincides with the average of the period from 1854 to 1871 when gold in terms of commodities showed the

greatest stability, rarely varying more than 5 per cent above or below this level on the average of any year. After that date, however, a very marked appreciation ensued, due no doubt to increasing demand and inadequate supply, and by 1896 gold had gained in purchasing power by nearly two-thirds (64 per cent), an increase of about $2\frac{1}{2}$ per cent per annum. From the opening up of the Transvaal the tide of falling prices turned, and at the outbreak of war the price-level had risen nearly 40 per cent from the lowest, denoting a fall in the purchasing power of gold of about 28 per cent.

The war brought about an immense upheaval in values and even after the drastic deflation of 1920-1 its purchasing power remained at only about 60 per cent of the 1913 figure. At that time, however, few nations had any hope of reverting to gold; its value therefore was dependent more or less on the use the United States made of their huge stocks. Our own return to gold was facilitated by a boom in the United States based on this large accumulation, and at that time gold stood at five-eights of its 1913 value, but the upward movement since then had been very rapid and to-day its purchasing power in wholesale prices is greater than in 1913.

The most marked movements on the basis of the *Statist* Index Number are recorded below:

World's Output of Gold. £'000	Year.	Value of Gold in purchasing power of wholesale Com- modities.
24,000 yearly average	1854-1870	100
25,500	1871	100
41,500	1896	164
52,000	1900	133
67,000	1903	145
85,000	1907	125
91,000	1908	137
96,000	1912-13	118
82,200	1925	71
82,200	1926	79
82,500	1927	82
83,600	1928	83
84,000	1929	87
85,000	1930	103
—	1931	118

It will be seen that the range of fluctuation is over 100 per cent, i.e. it has more than doubled the lowest and halved the highest figure, surely a lamentable record for a measuring-rod ; and even if we except the disturbances due to the war there remains a variation of nearly two-thirds of its value.

3. THE LAG

Perhaps one of the most unfortunate features of the gold standard is the "lag" which occurs before any action can be taken by the Bank of England, and which is inevitable under a metallic standard. The lag arises thus : If internal values in any country lose touch

with those prevailing elsewhere, either through a fall of prices abroad or through a rise of prices at home, the bank, under what is called the automatic principle, receives warning by a demand for the export of gold ; that warning, unfortunately, comes too late ; the rise in the future markets has already made considerable headway before the retail price is affected and the drain of gold becomes noticeable. Months may have elapsed ; and in point of fact the Bank of England is always compelled to act with drastic energy, 1 per cent in such circumstances being by custom the minimum rise in the Bank rate. But the lag operates both ways. Gold returns slowly, and at the very time that depression at home is deepening the Bank rate is maintained at a high figure because the automatic principle does not allow of the exercise of free judgment. Such a situation was responsible for the fatal deflation of 1920-1 which gave this country a blow from which it has not yet recovered. Currency management can never be sound that keeps no touch with those sensitive barometers, the future markets.

The nearest illustration we have of the present operation of the gold standard is that of a badly steered car which develops wide swings because the action of its driver is belated. The skilled driver's hand moves by anticipation with the

minimum force needed to effect a change of direction. The “automatic principle,” on the other hand, always operates after the event, and we can understand now why trade instead of pursuing a regular and steady development moves in wide swings of activity and depression lasting over several years even at the best of times. Each time trade tends to move into a vicious circle until the destruction of values is so great and production falls so low that famine conditions are engendered ; or, in the opposite swing as in the U.S.A. in 1928, until the future is mortgaged out of hand.

But these recurrent periods of activity and inactivity must be reserved for further discussion.

4. THE LINK WITH COMMERCE

We have traced very briefly the evolution of British banking and have shown how, despite the cramping legislation and imperfect foresight of its designers, the system has been so transformed by the ingenuity of the operators as to mark an immense advance on earlier conceptions of banking. The historic attempt to create a monopoly for the Bank of England and to place all note issues in its hands brought about the first conception of a Central Bank, and all the great nations have adopted this principle with adaptations or improvements to serve their own needs. Had not the joint-stock

banks found a way round the obstacle, Peel's Act of 1844 would have ruined our commerce, but the ingenuity of our bankers evolved the system of cheques and deposits which has practically supplanted the use of notes for all but retail transactions. But the development does not stop here. The joint-stock banks, by numerous amalgamations and the formation of branches, have created a system not unlike the vascular system of the body, where the circulation of money may be compared to the circulation of the blood, the pulse being regulated from the heart to the varying needs of the system. To the centre come supplies from all the out-lying parts to be redistributed where they can perform the best service, and every bank manager becomes a little nerve centre in touch with the public and responsive to its wants, while he is also responsive to the needs of the centre. At the heart of the system is the Bank of England with the constitution of its Board or "Court" designed to make it sympathetic to the needs of commerce, for, in theory at least, its members are representatives of finance or commerce rather than of banking.

Such an organization represents a most beneficent force, for it is free, like our judiciary, from political influence, and it may even be said that its functions are judicial in the sense that it is the arbiter of the most important term in all

contracts, the money element. It is responsible for the supply of money which regulates values, and by its action the distribution of the products of society can be justly allotted between the various components of production. This, indeed, is the ideal instrument, in which we may feel a legitimate pride. We have only to contrast the instability of the American banking structure with its almost countless banks and the grievous instability which such a loose structure engenders with its frequent failures. But if our system is so admirable, how comes it that the fruits are so bitter? Let us examine what it has set out to perform.

5. GOLD IN ACTION

In considering the purpose and functions of money the older economists looked to it to serve three important functions :

1. To provide a medium of exchange.
2. To provide a measure of value.
3. To provide a store of value.

On these grounds it should possess an intrinsic value of its own, should be as stable in value as possible and should contain the greatest value for the smallest bulk.

Judged by these three tests gold has failed us lamentably. Far from serving as a medium of exchange it is withheld from circulation in vast quantities. Out of the world's stock of £2,200

million the United States and France hold approximately three-fourths. The remainder is largely immobilized under legislation which like our own tends to sterilize it, and the free gold of the world is very little, if any, in excess of the annual output of the mines, as the Bank of England has good reason to know, i.e. about £80 millions per annum.

We have shown how gold has failed us through its instability as a measure of values. As Fawcett said, "How endless would be the confusion if the standard of length varied." There is not a contract or bargain entered into, not a lease made, not a rent fixed, not a loan contracted, short or long, that is not subject to the variations in the purchasing power of this metal. At one time it impoverishes the creditor only to heap riches on him later which he has neither asked nor deserved. It has much more than doubled the debts contracted by Europe to America, and by English producers to the owners of the national debt. It has arrested the wheels of progress by taking away the gains of the promoters and organizers of business. It has driven millions into unemployment, while it subjects all those who elect for a stable standard of living to the chances and changes of a fluctuating currency.

As a store of value, what is to be said for it? It makes a virtue of avarice through the temptation it offers to withhold it from the market, in

order to derive the unfair advantages that accrue to those who can create a corner in any rare and sought-after product. Goschen was indeed prophetic when he declared that any attempt to adopt gold as the sole principal standard throughout the world would produce a disastrous monetary crisis, and it is obvious why this is so. Loans contracted by debtors or debtor nations in gold are translated into goods at the creditor's price, for the debtor's needs put him at a disadvantage. The gold remains with the creditor and when repayment is due the debt is translated into goods, but again at the creditor's price, since he holds the gold and can dictate the terms on which he will convert it. These inequities were greatly intensified by the urgency of war demand, for it compelled the allies to pay the U.S.A. prices regardless of cost which they now have to repay fivefold or more in satisfaction of the original claim.

When war indemnities come to be settled in gold these evils reach their height. For the very foundation of international commerce is exchange, "value for value," and when that exchange is converted into "value for nothing" as between Germany and the United States, the whole fabric of exchange is reduced to chaos. Service becomes servitude without reward, and all parties suffer, for it is no satisfaction to the creditor to accept free imports which sterilize an

equal amount of his own labour and make it a public charge. The gold piles up in the coffers of the creditor and the debtor can only obtain it by falling more deeply into debt.

Much blame, no doubt, attaches to the short-sighted legislation enacted of recent years in all countries, legislation which ignores the fact that if gold is to be of any use as an international medium of exchange it must be employed merely for the settlement of international balances and need therefore only be held in moderate amounts. Before the war the Bank of England managed the world's credit with a stock of gold of no more than £30 millions. Had they held the £500 millions that France holds to-day, or the £1,000 millions that America now holds, they could not have controlled the exchanges any more effectively than they did, and would have incurred a vast sum in interest charges. The Bank, indeed, charged with the duty of managing the world's monetary needs conceived it to be their duty to repel gold if it showed signs of accumulating, and only sought to attract it if their stock fell below what was considered the limit of safety. After all, a nation's stock of gold is merely its "till money." The banker's art is to estimate just how much money he may be called upon to pay out and to hold no more than is consistent with his functions as a dealer in currency. If there is

any hope for the gold standard it can only come through a better understanding of its use and the application of some deterrent for the ignorant or the malefactor who destroys its utility by burying it in his vaults or hiding-places. Those who have withheld it from the market in such inordinate quantities may have gained advantages by so doing. They may, for instance, have received a larger tribute from their debtors or may have acquired greater political power in the councils of the nations ; but they have bought these advantages at the price of widespread misery and impoverishment not only to their debtors but to their own people. Currency properly used becomes a liberator, for it frees every one it touches for useful service to his fellows in place of slavish dependence on them.

6. THE EQUATION OF EXCHANGE

But even if gold were treated fairly there remains one radical defect which would defeat its usefulness. The normal expansion of the world's trade, allowing for a gradual increase of population, amounts to about 3 per cent per annum. The world's production of gold, as shown by statistics, is not increasing rapidly enough to keep pace with such an expansion, and the amount available for the exchange of produce is still further depleted by hoarding.

Now we may put as a very simple equation

the form in which gold and commodities are exchanged :

If G be the quantity of gold and P the quantity of produce available for exchange at any one moment, $G \times P = K$, where K is constant. This is merely the shortest way of saying that the quantity of gold supplied to the market, in other words "price," varies inversely as the quantity of goods supplied to the market, which we may call "production."

This is a simplified expression of the law of Supply and Demand, but it expresses at the same time the quantitative theory of money. It follows that if the production of goods to be marketed increases while the quantity of gold on the market remains unchanged, the larger production of goods will bring the producer no increase of return in gold.

The consequences that flow from this very elementary principle are deplorable and we are witnessing them now. As fast as the public strives to increase production and thereby to reduce costs, just as fast are its efforts sterilized. The producer reaps no more reward than before, and the cry goes up "Over-Production." The workmen acquire an instinctive fear that if they increase their production they will receive no benefit, and indeed under the gold standard as now worked it is impossible to convince them that this is not perfectly true. The wage fund

does in such circumstances remain unalterable. It represents the proportion of the total product that can be assigned to workers and which cannot vary unless at the expense of the other factors of production. Equally the organizers (entrepreneurs) who plan for increased production may succeed in extinguishing some of their rivals, but the benefit goes, not to them as a class, but to the holders of gold, or its equivalent in mortgages or other first charges. The case is still worse when the free gold is diminishing in supply ; the entrepreneurs' profit disappears, and diminished wages take the form of unemployment.

7. BIMETALLISM

The nineteenth century witnessed the conflict between gold and silver which resulted in the defeat of silver and its expulsion from most of the currencies of the world, except as token coinage. But for a long period the controversy raged round the adoption of Bimetallism, the proposal to establish a kind of "diarchy" in currency matters. Such a system could only have been made possible if the standard had been composed of definite proportions of each metal, for example, in something like the old relation of $15\frac{1}{2}$ parts of silver to one of gold. The United States of America who endeavoured to establish such a relation by the purchase of silver failed

for an obvious reason : the cost of production of any material that may be required in commerce ultimately governs the price, however much the variations of supply and demand may play upon it. But as costs of production constantly vary in every commodity in accordance with the progress of invention, improved technique, or other causes, no two commodities can be relied upon for any length of time to maintain a steady relation. The attempt to establish such a relation merely results in an overwhelming production of one or the other metal. We see similar instances in rubber, cotton, wheat, coffee, etc. For that very reason, England, by fixing too low a price for silver in the eighteenth century, lost her silver and attracted gold. America a century later, through fixing too favourable a price for silver, was overwhelmed with silver and had to abandon the metal to its fate. And now that silver has been abandoned by most nations, and has become merely a by-product of the mines, its value has sunk from the ratio of 1 : 15 $\frac{1}{2}$ as compared with gold to about one-eightieth.

Prominent bankers and economists have recently started a fresh campaign in support of bimetallism, and we have now advanced sufficiently far in the science of managing money to appreciate that nations could guarantee their currency notes by reference to a supply of gold and silver in certain definite proportions, and

that they could settle their differences either by shipments of an amalgam or by tendering the two metals in the specified ratio. But one great defect remains which will probably prove an insuperable barrier to such a system. We have already suffered sufficiently from the misuse and locking up of gold. The temptation to profit by a corner in silver would be too strong to be resisted by those endowed with the power to do it. As things are at present we are slaves to the holders of gold. We should then enter upon a new servitude hardly more tolerable than the old and should merely be substituting two quarrelsome tyrants for one.

8. A STABLE CURRENCY

In an age of democracy, when every member of the community is regarded as capable of taking his part in the government of his country, it is strange that a similar conception conferring the control of currency on the very commodities by which we measure its variations has been so little understood and has made so little headway. But the stage is laid for it. The world has by now realized that the titles of value that stand to-day for gold can no less easily stand for the widest possible group of those international commodities that enter into every transaction of our lives. It is by these we gauge the cost of living from age to age, and by these,

in the last analysis, that we settle our international dealings and differences. The power that the Bank of England exercises to-day in regulating our currency to its parity with gold, lies not in the stocks of gold retained in its coffers, not even in the stocks of gold that are borne by air to Paris or Amsterdam. That power appertains to the Bank simply by virtue of its control of the discount rate ; and by that both the volume of deposits and currency notes and the velocity of circulation are regulated. How powerful that control is can be gathered from the fact that Britain for five years has been able to maintain parity with gold, even when that metal has been appreciating rapidly, and has only failed now from causes which we have still to discuss. How much simpler would be the task of the Bank of England were its duty solely that of regulating the supply of currency in order to maintain a stable level of price in Great Britain for the widest possible group of the world's wholesale products. No institution in the world is so favourably placed for such a duty as the Bank of England, since London is not only the world's financial centre but the great emporium of all commodities. The city of London every day settles the price of every article of commerce that enters into international trade. The stability of our financial system owes not a little to that fact.

CHAPTER VI

AN ISOMETRIC CURRENCY

i. A CONVERTIBLE CURRENCY

WE have now arrived at the conception of what is meant by "isometric currency," sometimes called a "managed" currency, although our gold exchange standard is equally a "managed currency." Under this conception, the pound note represents a definite and unchanging purchasing power in relation to the principal products of the world, taken as a whole. It does not preclude variations in detail which are inevitable in markets where supplies are bound to vary, and habits and customs change ; but it does assure the holder of the pound that he, and all with whom he enters into trading relations, can rely on fair play, so far as the standard of measurement of values can secure it ; and it is even more convertible than gold, since all the great wholesale markets offer instant convertibility into any or all of the products that go to form the standard. That convertibility derives easily and naturally from the regulation of the currency so as to secure the stability of the index chosen.

We can at all times fill "our market basket," so to speak, in exchange for our pound sterling, and our neighbour with whom we trade can do the same, so that all parties are satisfied. If we lend money abroad our borrowers are assured that they will not be called upon to deliver double the amount they have borrowed in terms of the world's produce ; nor, on the other hand, will the widow and orphan have to contemplate the destruction of their home through the instability of the currency on which they depend. The Bank of England becomes the minister of justice and fair play to all alike at home and abroad, within the sphere of monetary action a ruthless enemy to spoliation.

Wage disputes, due to changes of purchasing power, will lose their meaning, and strikes and lock-outs will not waste the substance of the nation as they have done in the past, even if we still resort to that barbarous method of settling the terms of employment in industry. The world's productive power will be released from the present shackles and will bound forward. Much of the wasted ingenuity of those who spend their lives adjusting the irregularities of supply and demand to a changing monetary standard will be saved, and they will apply their services to more useful purposes.

The Bank of England is no longer concerned with watching the inflow and outflow of metal,

but with watching the movement of the index of values by which its action is regulated. Its business now is to assure the inviolability of the pound sterling in relation to products generally, not to act in relation merely to one metal.

But certain questions may be asked as to its mode of functioning.

2. INTERNATIONAL BALANCES

How will international balances be settled if gold ceases to be anything more than a product dealt in as silver or any other metal?

The answer to this is simple. The purchasing power of the British "sovereign" or currency unit is henceforth guaranteed. The holder, whether at home or abroad, can instantly convert it into any or all of the products for which it stands by simply applying at the various wholesale markets. The only markets which can rank in the index of values are, in fact, those where money is instantly convertible. The markets for cotton, for wheat, for rubber, for sugar and for metals are all typical of this class. An order to buy or sell can be executed within a few minutes, in fact much more quickly than it takes now to secure the equivalent in gold. The holder of currency thus knows that he can obtain value for his money "on the nail." Money, under this conception, no longer stands for the production of any one single article, but for pro-

duction in general ; and the goods so bought are instantly available for shipment in settlement of international indebtedness. There is no longer either the dangerous drain of gold, or the forced liquidation to find it, with the consequent disturbance of all markets. Yet if any nation wants a shipment of gold, it can secure it as easily as it secures silver at present. Gold can be as freely dealt in as any other commodity. But we know in actual practice that international settlements are in the last analysis settled not by shipments of gold, but of goods, and much of the present futile transference of gold will cease, thus stimulating international trade. A stable pound will be a much more welcome object of exchange than a piece of gold of variable value. If we could eliminate the folly of never-ending shipments and counter-shipments of metal, we should have done much to convince the nations that international trade *really* means exchange of products, and should hasten the era of genuine free trade ; but best of all would it be to raise our national debt to the high honour of representing a definite volume of the world's production for which Britain is the central market. It will then become a title accepted everywhere as solid value, not as the fiction that it was backed by gold when the painful truth was that all the gold in the world would cover but one-fourth of its value.

3. WHAT IS TO REPLACE GOLD?

What will the Bank of England carry in place of gold?

If gold and silver should both be reduced to the status of commodities to be bought and sold as required and thus become subject to open fluctuations in value, it is obvious that they will have lost most of their merit as a security. In point of fact the Bank of England carries some silver, but a very small amount, for it is not the business of a bank to hold any commodity, least of all a speculative one, and this form of cover is treated merely as fiduciary. But observe that, from the moment stable values become the objective for the Bank, fixed-interest bearing securities acquire a new meaning. They are now long-term loans which are guaranteed a return, fixed and at all times equal in purchasing power, and no longer varying with the fluctuations of gold. They have thus a fixed relation to production, and they become more readily convertible for that very reason, for the holders can never be deprived by inflation of their just rights, as they have so often been in the past ; even if, *per contra*, they cannot hope to secure the illegitimate profits of deflation at the expense of the general public. In point of fact, the existing practice of all banks is to hold their deposits guaranteed by such fluid forms of investment, and fixed-interest bearing stocks of a high order will thus, as at

present, constitute a substantial proportion of a Central Bank's reserve. Indeed they will be far more liquid than now, for every one knows that any attempt to convert gilt-edged stocks into actual gold would precipitate a crisis. But there is a holding which is even more liquid than these, viz. the bills of exchange of the mercantile community, and these are ideal for a Central Bank from the point of view that they represent the actual exchange of goods between producer and consumer which it is the business of all banks to facilitate. A third form which bankers' holdings generally take is "advances to traders," but this, which is the most legitimate field for the joint-stock Bank, indeed one of its main purposes, can be of little advantage to a Central Bank since the calling in of advances can never be carried out precipitately without grave injury to industry, and the purpose of a Central Bank is to give stability to the whole economic structure.

The holding of securities gives the Bank added powers over the stock markets which are very important in these days and establishes a link with Government borrowing.

4. CREDIT

How will the Bank expand and contract credit?

The expansion and contraction of credit really arise from the activity or inactivity of trade, and therefore primarily from the so-

called "entrepreneur," the class which originates enterprise and depends on profit only for its reward. The demand for money therefore primarily comes from this class, and it is a well-recognized fact that if through one cause or another the "entrepreneur" is not adequately compensated for his enterprise, even the lowest rates for money will not tempt him to activity. This phenomenon is only too apparent at the present moment. Money fails to pass from short-term credit to long-term credit or definite investment, because the wholesale fall in prices of commodities and stocks has undermined the confidence of the investor. Heavy taxation adds substantially to his burden and is an additional deterrent, but to aggravate matters, taxation has grown heavier in its incidence just because of the catastrophic fall of prices. Thus we arrive at the truth that the instability of the price-level in itself is sufficient to cause cheap money to be ineffective, and to this we can attribute one of the most important causes that intensify the trade cycle, and the main reason why a low rate for money has failed to bring about the trade revival which the Bank of England confidently expected to result from it.

A complete understanding of the connection between our banking and mercantile systems would prove that the Banks need never be called upon to press note issues into circulation.

The demand will come normally without pressure from the public if all parties to production are certain of fair treatment. But the situation to-day is not normal. The body of industry is suffering acutely, and the disastrous and unexampled unemployment of these days calls for special remedies which will be dealt with later.

5. CURRENCY AND PRODUCTION

There remains to discuss yet another question. We have witnessed a period of rapidly increasing productivity since the dark days of the war. The gold standard has failed to provide the means for the marketing of this increased production. By its very nature an isometric currency should provide for the necessary expansion, and on such conditions over-production in the general sense becomes impossible, consumption being equated to production. But is it not still possible that we may have unbalanced production? That indeed is always possible, indeed inevitable in a world of change, but it will more quickly correct itself if the scales are held evenly as between one class of producer and another; and this can be achieved if the standard of values is founded on the great basic commodities, for they are least amenable to the manipulation of individuals or groups through the world-wide character of their production and use, and the vast variety of interests engaged.

If productivity increases and savings are effected in the cost of production, the circulation of money will expand, and the whole world will benefit. If under such conditions enterprise should be stimulated in new fields of endeavour, it will be healthy enterprise founded on the knowledge that inflation, whether of wages or of stock values, will be quickly suppressed ; money borrowed for new enterprises will be related directly to production, and not as at present to a metal of strictly limited utility. Thus bondholders, wage earners and organizers will each be sure of a fair apportionment. Under such conditions of stability, the temptation to build up higher and ever higher a crazy structure of imaginary values founded on equally imaginary profits will with difficulty secure a foothold.

Should the bounty of nature fail, on the other hand, so that a rising tendency manifests itself in the general level of prices, the curb of rising money rates will bring about the necessary restriction of the circulation as it does now. That restriction will take effect most directly on the risk-bearer who is best equipped to carry the responsibilities of fluctuating markets, and whose business it is to provide by his foresight for just such contingencies. But nothing will relieve the community of the consequences of shortage, and money will remain in market parlance "tight" till the situation is relieved.

New and constructive developments which are more proper to periods of plenty cannot under any circumstances flourish at such times ; nor can hardships be avoided ; but the absurdity of having unemployment and bad trade in times of bounty will for ever be banished.

The problem of curbing stock exchange excesses is merely that of making the discount rate effective, and in this respect the British banking structure is far superior to any other that has ever been evolved. It has been built up bit by bit by the unique experience of generation after generation, and has stood the test of time. Indeed, we may stand amazed at the strain that has been borne in the last twelve years, while ruin and bankruptcy have devastated even the strongest of our rivals. There is nothing to fear from an organization that has stood firm under the suspension of gold payments by the Bank of England. It has set the world such an example of calmness and courage as to confound our sternest critics, while it has given other nations confidence to remain in our fold and to share in the consequences. That indeed is a testimony which should fill our hearts with pride. It came not because of an adherence to gold—past or promised—but because the world believes in our honesty, our integrity, our determination to uphold the cause of justice if the heavens fall.

CHAPTER VII

GOLD AND ITS ALTERNATIVES

I. A NEW EQUATION

WE gave in Chapter VI a simple equation for the theory of supply and demand in the form $G \times P = K$, connecting gold and production as in inverse ratio to each other. In an isometric currency that equation changes its form and becomes $P = C \times K$, in which P stands for production or the supply offered in the market and C for the currency or circulatory medium, K remaining constant. In other words, there is now a direct relation between the volume of production and the volume of currency, with the result that any increase of production will lead to an expansion of the currency sufficient to keep prices constant ; any decrease of production will lead to a reduction of the currency to compensate the decrease. Prices no longer move in inverse proportion to the currency supply. The producer who stimulates his production will therefore be working in an atmosphere which favours the expansion of trade ; more money will cir-

culate as he increases his efforts and he and his fellows will share in the benefits of increased production. The benefits will accrue not, as at present, merely to the holders of gold or its equivalent.

Perhaps an illustration will elucidate the case. A family who supply their annual needs from an orchard institute a system by which each member receives his share on presenting tickets entitling him to so many pounds of apples. But the crop of apples varies from season to season ; sometimes it is bountiful, sometimes it is meagre. Therefore when the crop is plentiful a larger supply of tickets is distributed, and the holder may consume more, or reserve more for his future needs. If the crop is deficient a smaller supply of tickets will go "into circulation," and the demand will therefore be regulated to the supply. In such circumstances there can never be over-production such as occurs now, when men and women starve in the midst of plenty. We shall not hear such absurdities as people burning their crops in one country while men and women are forced out of employment in another, because they cannot exchange their products and must therefore starve. Produce becomes the real currency as in the case of the apples, and the bounty of Providence proves to be the blessing which it was intended to be, rather than a

curse as it is now regarded, because our faulty monetary system impedes its distribution. Could anything be more harrowing, yet senseless, than to read that while millions are dying in China for want of food, the farmers in America are in despair because of their too abundant crops, while Brazil burns or barters her coffee for wheat because gold cannot effect the exchange. A world back to barter while the gold that was meant to facilitate exchange lies buried deep in cellars where it may not even glitter, condemned like an evil demon to age-long confinement !

2. UNEMPLOYMENT AND FAMINE

It has been said that unemployment is a sign of famine. There is a depth of meaning in this which is worth exploring. When crops fail there is no reserve for the creation of capital, and without capital employment declines. When crops are bountiful there is a surplus and that surplus creates a reserve. Each worker can produce more for the same labour, therefore labour is freed for new employment. Progress should follow because the reserve represents capital and it is capital which gives employment. Nature's bounty can thus be converted to man's advantage, and there can be little doubt that this is the history of most great advances in civilization. The amazing progress of

the nineteenth century which increased Britain's population from some 15 millions to nearly 45 millions, became possible because, with the discovery of steam power, each individual could provide for a much larger number of his fellows and could thus release men and women for the new developments which followed in amazingly quick succession.

The twentieth century has continued this progress. The bounty from which we are "*suffering*" to-day should create employment. The reserves should be convertible as they were in the Middle Ages into great works of art and architecture, or as they were in the previous generation, into beneficent works of progress: ships, railways, bridges, new territory opened up new achievements in science. Why then are they not so convertible to-day? Why is our progress arrested? Why in effect does bounty spell unemployment? Why does the fertility of Nature lead to the infertility of man in the field of productivity? *The famine we are suffering from to-day is purely and simply the sterilization of productive labour, due to the inadequacy of the means of exchange.*

3. UNJUST DISTRIBUTION

We have shown that the most crying defect of the gold standard is its unjust distribution of the product of society. If we go back to

our illustration of the orchard we may imagine that the members of the family have three different kinds of claim on the product of the orchard. John Smith has purchased the land and planted the orchard. Henry has advanced the money for purchase and has stipulated for a fixed return. Tom has performed all the daily necessary work to make it fruitful and his remuneration has been fixed so as to secure him a reward whether the orchard is fertile or unfertile.

Obviously the claims of Henry and Tom must be satisfied before the claim of John can be dealt with. Assume now that the distribution takes place in the currency of the apples themselves. If the orchard yields more bountifully than John's estimate, he will find himself with a reserve with which he can extend his operations, thus employing more men like Tom and repaying Henry, who is now able to reinvest what he has been repaid and to create new employment by relending his capital.

But supposing the bargain was fixed in gold which has so changed its value that Henry and Tom can now claim twice their previous share. John now finds that he cannot satisfy both Henry and Tom. He must discharge Tom and do the work himself as best he can ; and he must satisfy Henry, who now receives a two-thirds share. But Henry is the safe type of investor. He does not undertake risks,

especially with John's fate as a warning to him, and will not therefore extend John's operations. Tom therefore remains unemployed. John falls increasingly into debt to Henry, and if a bad crop ensues goes into bankruptcy because he loses his remaining share. Henry enters into possession without the power or experience to make his property fruitful, for John, who had the knowledge, is down and out. All have suffered.

Here undeniably we have an epitome of the history of British industry during the last few years, and the facts can be verified all over the country in the condition of our once great and flourishing staple trades. We need not cite the whole list, which includes coal, cotton, wool, iron, steel, shipbuilding, linen, jute, and many more than we can name here. The situation has, of course, been aggravated by the conversion of a huge war debt to gold which has many times multiplied the so-called "fixed" interest-bearing securities of Great Britain, securities which are now exacting a daily increasing toll on the nation's production. As if this were not enough, we have piled an almost equal burden of social services on top of this and fixed it also in terms of gold.

4. THE WAGE STANDARD AND UNEMPLOYMENT

We have suggested above that John saves the situation by discharging Tom. Now labour is

subject to the law of supply and demand like anything else. There is now a surplus of labour which can only find employment by equating its reward to the diminished margin accruing to John and Tom after Henry is satisfied. In other words, a fall of wages is indicated. But modern nations recognize a duty to the helpless wage-earner. The workman is encouraged to form Trade Unions which are in effect organized trusts for the sale of his labour, and the State has instituted Trade Boards in trades where these are lacking. Although the latter are constituted of an equal number of representatives of employers and employees, the casting vote is given by an independent chairman drawn from the civil service, and the duty imposed upon that chairman is without question that of securing an adequate living wage to the employees. The effect of this arrangement is to stabilize wages at what is practically a fixed figure without regard to the capacity of the industry to meet the additional charge.

Now every manufacturer knows that the basic factor in his production is the amount of wages he pays. Capital embarked in an enterprise is subject to a variable reward, but wages must be paid whatever happens and the price of the product has therefore a very definite relation to the expenditure on wages, as every one knows who is accustomed to making up costs.

Now it is perfectly possible to fix a wage standard independent of the gold standard which will govern the value of goods ; and such a standard can be managed on precisely the same principles as the gold standard, provided that the responsible institution, with the backing of the Banking community, is prepared, at all times, to buy in the surplus of labour at a fixed price and to fix the sale price for the labour it offers in the open market, on precisely the same principles as govern the gold standard.

Such a standard, of course, has no relation to the gold standard and can only be enforced if the responsible monetary authority, say the Bank of England, is prepared to regulate its price for "money," not as it does now, by reference to the excess or insufficiency of gold, but in conformity with the excess or insufficiency of labour. Gold will now be displaced from its former function and the sole arbiter of the sufficiency of currency or credit will be the state of employment. There is much to be said for such a system which would aim at securing the full working efficiency of our people, but it could not become an international system, and for that reason would tend to injure England's power as a centre of world finance.

But it will now be grasped that the cardinal error we are making to-day as a nation, is to endeavour to run both systems at the same

time, despite the warnings of history. When the United States believed that by free purchases of silver they could maintain gold and silver at a fixed ratio, they made the same mistake. We are merely having the same experience in another field of action and one or other standard has to give way, as happened in America.

Once again the old story has repeated itself. It was already evident, even two years ago, and the warning was given to those who could inform the public, but perhaps it was treason to declare it, and the effort to reconcile the irreconcilables continued. To-day the gold standard has gone.

The most unfortunate feature is that in making the attempt, we have lost our power to finance the world. Our labour runs to waste, and the world, which depends on the faithful fulfilment of our duty as its monetary centre, suffers almost immeasurably. We, the world's bankers, are driven to borrow from our neighbours, and have become one of the dearest markets for money; and we must not forget that when her banker fails the rest of the world suffers, no matter how blameless it may be.

5. RETAIL PRICE STANDARD

It may be opportune at this point to take brief notice of other systems of currency which

have been suggested. The *retail price-level* has by some been regarded as the best standard of measurement of values ; and in point of fact the retail price plays a very material part in the fixation of wage-levels. But unfortunately the retail price-level is itself largely dependent on the wage-level, and furthermore into that level of prices enters national taxation, both directly and indirectly. As an international counter it thus stands condemned. It varies much more slowly than the wholesale level, and is thus insensitive to world conditions, nor does it offer that rapid facility for conversion that applies to the great international wholesale markets.

Another school advocates the acceptance of *wheat* as a standard of measurement, wheat being regarded as the staff of life. We have already shown the objections to a monometallic basis, and these objections apply still more forcibly to the selection of a single food product which is as variable in supply as wheat. If, in fact, our objective is a stable unit of measurement, the wider the group to which it is referred the greater the stability, as we thus eliminate casual fluctuations due to the vicissitudes of climate and other uncertainties. A final objection to such a standard as wheat is that it is not the staple food of the East, but only of the West.

6. FIXED INTEREST STANDARD

A Swiss economist has suggested that a fixed bank rate would be ideal, ignoring the fact that the very weapon by which we control currency to the fluctuations of supply and demand, would then be discarded from our armoury. Whatever the benefit to be derived from a system under which money could always be borrowed at a fixed rate, it cannot be overlooked that, apart from the instability of the price-level which would result, there are great variations from time to time in the need for money for enterprise. Great inventions, like steam power, electricity, the radio, the internal-combustion engine and the aeroplane, have always called for very rapid expansion and the conservation of capital reserves for that purpose. A fixed rate would fail to make any allowance for this. It assumes that the progress of humanity is stabilized and regular. An outbreak of war would stultify the whole system, for the increased need of supplies would not allow of the same rate of interest being offered as in peace time.

Finally, it is possible to conceive of a currency regulated to maintain par values for Government securities, which would in effect mean the maintenance of a stable return to investors. This would have much the same effect as fixing the rate of interest and the objections therefore need not be discussed.

CHAPTER VIII

WAR AND CURRENCY

I. EFFECTS OF WAR

THERE remains to consider what effect war would have on an "isometric" currency. We are well aware through the experience of past events that the gold standard failed to stand the strain of war. Can an isometric currency, imposing on the Bank the duty of maintaining stable values, stand the strain any better? Let us first ask ourselves what precisely is the significance of war on a nation's economy. It means a rapid change over from one form of activity to another at the very time that the number of producers are reduced by the call to military service. If the currency is not to be deranged the demands of consumers must be curtailed also. That cannot mean prosperity, but war cannot mean prosperity. It was one of the scandals of the Great War that those who stayed at home prospered and profited, while those who risked their lives in the field and sacrificed future prospects at home had to accept the most meagre reward.

We cannot escape the fact that all the efforts to win a war must be made during the war. They cannot be postponed till a later date. If new services have to be evolved, new energies stimulated, they must be called forth not by the temptations of great reward but by loyalty and patriotism, or by submission to a dictatorship that controls every activity of a great people in its devotion to a great cause.

England finds herself in her present plight mainly because she inflated grossly through the extravagant wages and profits paid out of borrowed money, and because she then converted the inflated debts thus contracted into terms of gold.

2. INFLATION AND DEFLATION

At this point it is fitting that we should define what we mean by inflation and deflation, terms which are a good deal misused and are frequently turned into the language of abuse among controversialists.

Inflation denotes an expansion of currency or credit which creates buying power in excess of production. The sign of inflation is thus a rise of prices. Deflation denotes a contraction of currency or credit which reduces buying power below the volume of production. The sign of deflation is therefore a falling price-level.

Now inflation in England during the war took a somewhat insidious form. The Government

created purchasing power for itself by borrowing from the public, but the public was itself supplied with the funds to lend by an expansion of currency and credit through the banks in response to the demand of the public for more currency. The price-level notwithstanding all efforts to control it by officials, naturally responded rapidly. The debt thus created was not the genuine debt created by the abstinence of the lenders. It was fictitious wealth based on the inflated profits of war time due to the urgent call for supplies. Inflation in such a case arises primarily from the creation of long-term claims on production without any compensating increase of production. It is true that there is no immediate claim in respect of the principal, but the claim ranks with all other capital claims for its share in respect of interest. It was created in this case by relaxed control over currency demands. Direct inflation by a government issuing paper to pay for its purchases is only less virtuous in appearance.

The maintenance of peace-time demands is not consistent with the creation of war supplies. If savings are wanted for war purposes they must be genuine savings. Conscription that is confined to throwing the youth of the nation into the holocaust of war, while exempting the rest of the nation and licensing them for unreserved profiteering, is unfair and dishonest.

It is not to be wondered at that our victory has proved so barren, for it would not be too much to say that the men who won the victory have been betrayed. They returned to find that the bulk of war expenditure was fastened upon the very generation who had borne and survived the heat of the struggle, and upon the children who had no control over the matter, while the country is so overwhelmingly overburdened with debt that it cannot save the capital necessary to revive its industries, to restore its finances, or to foster the foreign and colonial development by which alone our country holds its place in the world.

The unfairness of all these things was dimly perceived during the war and aroused the cry of "conscription of capital" without any very clear idea of how it was to be carried out. The truth is that in any great national emergency the Government has the power to direct the activities of the whole people, including the use made of their capital. No Government would be justified in acting unfairly by taking any one man's property without compensation; but it has power to levy equally on all. It is in duty bound to make the best use of the services and material placed at its disposal, and any Government that acted loyally to all would, by the very strictness of its control, prevent all those excesses that lead to inflation. The Central

Bank would thus find its task relatively simple, that of co-operating with Government in supplying no more than the just needs of currency and credit to maintain the efficient conduct of war. In this respect the gold standard had no influence whatever either here or abroad, not even in the United States which never parted company with it.

3. PEACE AND WAR

Peace and prosperity have always been associated. But prosperity is nowadays turned into adversity by carrying the liabilities of war into peace time and multiplying these by the very increase of productivity that should give us renewed prosperity. And a new phenomenon in international politics has sprung up which has never been encountered before on the same scale. Vast international debts fixed in terms of gold dominate the world's markets. These debts can only be discharged either by shipments of gold, by contracting fresh liabilities, or by consigning produce to the creditors, the value of which is determined only by the moderation of the holders of gold ; for, obviously, if all values are fixed by gold, the holders of gold have the power to fix all values. Gold under these circumstances becomes a means to world power. However dubious may be the origin of the "Protocols of the Elders of Zion," this profound

truth was grasped by the authors when they discovered in gold the means to world domination. It creates a form of enslavement ; nor can France be blamed if she finds in this instrument a ready means to political domination.

The struggle for power took the same form under the Roman peace and contributed largely to the eventual destruction of that great system of government. It means war in its most dangerously insidious form, and like all war, is cruel and destructive in its consequences. If we regard war as merely a greatly intensified struggle for existence between nations, these are precisely the conditions under which the nations are living to-day, although theoretically at peace ; and to this is added the ever-present danger that harassed and down-trodden peoples may rise in fury or despair to throw off an intolerable yoke. The danger in Germany is not to be ignored.

Admittedly England won her way to power on the gold standard, and the increasing tribute that has flowed to her shores in the form of goods to settle our claims in gold for interest, etc., has enabled her so far to maintain the standard of living and to carry a volume of idleness that would have ruined any less wealthy nation. To hold the world in fee is indeed a proud achievement, but the seething discontent of the Eastern peoples is already making itself felt, and its

origins are traced by acute observers to the very causes that have enriched us through spurning silver and claiming gold as the sole form of payment. British power like Roman power has always been *rooted in justice*, and when injustice occurs, even when its origins are hidden, the stability of that power is already threatened.

4. CONCEALED INFLATION

There is an interesting corollary to this discussion of inflation which helps to illustrate its real nature. A nation which pays off unproductive debt out of its earnings as rapidly as America has done since the war, should, in compensation, reduce its currency and credit structure *pari passu* with the repayment of debt. By so doing it will avoid inflation through leaving a larger volume of currency in circulation than is needed. In ten years following the war the United States succeeded in reducing the volume of the National debt by one-third, or nearly £3,500 million. They did not however realize that this reduction would necessitate an equivalent contraction in the credit structure, if inflation was to be avoided. The surplus credit thus made available to the public was at first used to finance nations like Germany, Canada, the South American republics and other states, and the United States became a very generous lender. There is a limit, how-

ever, to such generosity where the possibilities in this direction have been exhausted through the lack of security that the debtor can offer for any further loans ; especially when the service of those loans demands an increasing volume of produce.

The surplus credit now found a new outlet in the American stock markets which rose out of hand and reduced the yield to an uneconomic level. The inevitable result was a stimulus to expenditure. Profits on the sale of stocks on a rising market were regarded as earnings available for expenditure ; and unfortunately the United States Government so interprets them, unlike our own Government which more wisely regards such profits merely as "capital appreciation." The steady repayment of large blocks of Government debt had thus all the effect of inflation of the currency by converting deferred claims in respect of capital into claims on current production. Buying was further stimulated by the use of credit for sales by instalments, which, however sound in normal conditions, meant the mortgaging of future spending power in order to stimulate present spending. In general terms the surplus credit thus created was operating in America precisely like currency inflation, and America could only continue on these lines so long as the credits were not exhausted, nor the borrowers asked to repay. When the latter

stage came the whole structure collapsed because the demand was artificial. Imports from abroad had now to take the place of exports. The stream was reversed. The precipitate revaluation of securities that followed had all the effect of a drastic deflation, for false titles to wealth were rapidly extinguished. Losses could not be met out of profits already dissipated, and a collapse ensued in place of the orderly contraction of credit that might have been effected had there been a better understanding of the connection between unproductive debt and currency regulation. Unfortunately the American price-level failed to indicate the danger. Although apparently betraying no signs of inflation, it was still based on the abnormal conditions following the war, when production was at a low level and consumption at a high level. A readjustment was due, if only in response to the contraction of war debts, but the road to this was blocked by a high tariff policy designed to exclude the products of Europe so far as it was possible to do so, and bound therefore to obstruct the process of readjustment. The option offered to her debtors of paying in gold or smashing the markets to overcome the barrier, was bound to bring its own Nemesis.

The lesson of these events for the Central Banks is clear. No Central Bank dare ever lose sight of the fact that its action becomes effective

mainly through its control over the yield of securities, gilt edged or even industrial, because these constitute so large a proportion of the paper titles to wealth that have to be brought into relation with the currency standard. Gilt-edged securities hold a prominent place in every banker's assets, but they would cease to be a sound holding if the yield failed to conform with the Discount Rate. The Bank rate must be made effective in every sphere of value. If the Central Bank is not strong enough to achieve this end, it cannot fulfil its purpose: but the means by which a Central Bank can control a Stock Exchange boom are of too special a character to discuss here.

5. ILLUSORY DEFLATION

Deflation in England proceeded on a course almost diametrically opposite to the events in America just described. We believed that a shrinkage of currency made without reference to a shrinkage in the unproductive debt would bring about true deflation and raise the value of the pound sterling. In effect by so doing we deprived productive industry of the legitimate support it needed. Already too large a proportion of the nation's credit and currency was pledged for non-industrial purposes. Therefore production shrank to conform with the reduced volume of credit available. This phenomenon

was not confined to Britain. In fact, it might be claimed that the first efforts towards rationalization in Germany were inspired by the realization that production must be rationed in conformity with the volume of currency and credit if a disastrous fall of prices was to be avoided. Obviously rationalization that does not control production is ineffective. Even if it be confined to closing down inefficient plant its purpose is the same: to equate production with consumption. It is not necessary here to dilate further upon the intimate connection between consumptive demand and the monetary supply which makes them almost equivalent terms.

CHAPTER IX

THE CREDIT CYCLE

I. THE TRADE CYCLE

THE trade cycle is so well known a phenomenon that it is accepted as a matter of course by both the business and the political world, notwithstanding the cruelties it inflicts on each successive generation. All kinds of explanations have been offered for this troublesome occurrence in which periods of prosperity alternate with periods of adversity, and which, too often, drives the younger nations, who are most vulnerable to changes of this kind, into that form of national bankruptcy, which shows itself in a break of the exchanges. Jevons in 1878 gave a good deal of study to this subject and found a cyclical movement lasting over periods of about ten years, which led him to the conclusion that there was an intimate connection between these and the extra-mundane phenomenon of sunspots. This he traced to weather variations, resulting in changes in world productivity.

The Great War has naturally disturbed the

sequence of events, and subsequent developments have added appreciably to the difficulties of testing such a hypothesis ; but the trade cycle still remains to disturb us, and the oscillations as we might expect after a great storm, are more ample and more frequent. A four-year cycle may be traced even within the rhythm of vaster movements. But without going deeper we must ask ourselves why, under our present monetary system, such wide variations are possible. Where is the variable in the equation of supply and demand that gives such free rein to the unknown ?

2. THE ELUSIVE FACTOR

If gold were the perfect medium of exchange that so many believe it to be, it would not only be invariable in value, but it would at all times be sufficient to effect the equitable exchange of every product on earth. Unfortunately the relative fixity of the supply does not lend itself to the variations of supply and demand due to seasonal and other causes, and trade has therefore to be conducted by means of the fiction called "credit" which is, in effect, nothing more than the promise to pay gold *at some future time*. It is credit, therefore, which supplies the elasticity wanting in gold, and credit has been developed into such a variety of forms that it now constitutes by far the greater part of the media of exchange. But credit, the mere

promise to pay at some future date, is a very dangerous form of currency. It is a bluff which may be called, and has been called time after time, provoking in England the temporary suspension of the gold standard or, as it is called, the suspension of the Bank Act, under which the Bank of England is compelled to honour its promises in gold. The world thus lives in a state of perpetual uncertainty, for we delude ourselves into the belief that we have a gold standard which would really mean that all payments can literally be effected in gold, instead of a "gold plus credit" standard. Now credit is a most elusive factor. It is the "X" in the equation of exchange, which now becomes not $G \times P = K$ but $(G + X) \times P = K$ where "X" is a variable dependent on the confidence of the public. In other words, production is now marketed in terms of a unit which contains a most deceitful and unreliable element. The X which here stands for credit, is a very irresponsible X. If it were strictly proportionate to G, the volume of gold on offer, its effect would be calculable; but in point of fact, it is supplied by the bankers to provide for a variable or expanding production. If it bears some relation to the supply of gold, it also bears some relation to the supply of goods, as the banker creates credit in response to material production. He is, in this sense, the servant of producers,

but in giving them his support, he is building on an unsound foundation. He is still governed by the simple fact that increased production means lower prices under the gold standard and does not warrant increase of credit. Any increase he grants, therefore, means an extension of credit based simply on the confidence of the public in his powers of control over the movements of gold. Like a "bear" in the Stock Exchange he is contracting to deliver what he has not got. The result of a more liberal credit policy is a trade expansion with rising prices, which stimulates speculation and favours producers. A growth of production ensues, which will continue under the conditions of an elastic credit structure until production is built up in excess of consumers' demand. This process may continue for two or three years, as plans projected for increasing areas of cultivation, new buildings or new productive plant, may take a period of years to bring to fruition : and in the meantime money is circulating in respect of the demand for construction and preparation. The moment that this increased production becomes available the upward tendency of prices is arrested. Confidence in the future of values becomes a diminishing quantity ; and credit, which we have shown to be a product of confidence, enters upon the shrinking process. The decline now

becomes cumulative and the process continues until the destruction of values leads to a loss of productivity sufficient to create positive scarcity. If the latter condition has not been conspicuous during the last few years, it is because we have passed from the most destructive war in history to a period of high productivity through the steady influx of newcomers into industrial production, coupled with improved processes, some of which were evolved as a consequence of war when labour-saving devices were imperative and urgent. Women, too, partly as a consequence of war, play a much greater part in profit-earning occupations, while the heavy fall in the birth-rate means a lessened number of consumers, and the liberation of more of the sex into the sphere of production. Finally nations who experienced difficulty in securing supplies during the great world conflict, turned to industrial production themselves or improved their equipment and thus swelled the total volume of production.

All this increased productivity called for a rapid extension of credit, which was readily made available, but with which the gold supply could not keep pace. The over-extension was not perceived so long as the debtor nations were not called upon to fulfil their obligations, or so long as they could discharge them by the simple process of contracting fresh loans. It

was only a matter of time, therefore, for the whole structure to become top-heavy and the revulsion was all the sharper because of the magnitude of the artificial claims on gold that had been created during or since the war. The biggest of these is of course the British national debt, and the heaviest international claim is the American claim for payment of external war debts. With the destruction of confidence and the consequent shrinkage of credit, debtors, whether nations or individuals, were at once at the mercy of the gold supply, and the gold has piled up ever since in those countries where the claims were strongest, viz. in the U.S.A. and in France.

3. A VARIABLE MEASURE

The effect of the variable credit cycle has thus, as we can witness for ourselves, been vastly intensified. But the mischief does not end here.

Every mercantile contract is made, at least in theory, for the benefit of both parties to it, and the transfer of wealth from creditor to debtor is no exception. It has the definite purpose of fostering production and its just interpretation is thus a matter of public policy. Now Britain is the world's banker and has a duty to the world, which she fulfilled through the nineteenth century, and after, by backing

up the pioneers who developed her Empire, and by assisting all those rising nations, East and West, whose prosperity made our prosperity.

But the wide oscillations in the gold credit standard have made a material variation in the terms of the contracts by which this duty is defined. Britain has been receiving a yearly increasing tribute in the form of actual produce from her debtors, who are falling more deeply into debt in terms of their own production as prices fall and more goods have to be tendered in satisfaction of our claims. It is, indeed, as if, without any service rendered on our part or asked for, they had daily contracted fresh loans and more deeply pledged their resources to us. The service becomes one-sided, their power to borrow decreases, and all that great organization of British trades designed to minister to the need of producing capital goods in support of our lendings is brought to naught, as our export returns show. Its place is taken by an unearned and unwanted increment. We feed our own population out of the increasing tribute that we receive, and are still able to exist apparently on our past services without concerning ourselves about the future when this unearned increment will cease and the impoverishment of our debtors will definitely come home to us. Nevertheless we owe it as a duty to the world to continue our banking services, to convert our

idle millions of workers into the productive agency that is needed for the development of those young nations who were wont to rely on us. It is our business, as the world's bankers, to make a fair deal with our debtors ; and debtor here does not imply any inferiority of status ; it is, or should mean an honest bargain for mutual profit. Recent events have shown that we reap no advantage from a bad bargain ; for that matter no nation or individual ever does.

4. THE UNCONTROLLABLE ELEMENT

But these are not the only losses attributable to the "gold plus variable credit" standard. Instability adds immensely to the cost of distribution as risks of loss have to be provided for, and the very nature of the importing and distributing markets makes it necessary to spread risks as widely as possible for the safety of all. That may mean, under present conditions, needlessly large stocks and the lock-up of unnecessary capital ; and at all times an unnecessarily large body of dealers and brokers to share the risks of trading. We need not enlarge on the sufferings these variations inflict on the public. Individually we can conform with wide variations in the credit cycle, but only because we are able to keep in step by alternating between the simple life and free indulgence.

Whether such conditions are a good discipline for us is questionable indeed. The simple life is unfortunately never in harmony with the conditions of so-called "over-production" that are characteristic of "bad trade." Hence the varying counsels of the economist to stint and to spend which bewilder the public. It may be said, "It is an ill wind that blows nobody good." The holders of gold or its equivalent and the "bears" who profit by disaster will enjoy what others lose. But that means a shifting of occupations in order to serve a new group of interests, accepting a new set of masters ; and apart from the sufferings this inflicts on the masses who depend on relative stability for steady employment, there is inevitably in the process of shifting a serious loss of production in general, and therefore a general lowering of the standard of comfort.

We cannot burke the truth. The system under which the world is working to-day is certainly not the gold standard *pur sang*. If gold performed its function, it would move throughout the mercantile and industrial organization as freely as oil moves through a machine, and would never clog at any point. What we are endeavouring to work unsuccessfully is a dangerously variable credit standard, weighted with immense public obligations and having only a loose connection with gold except at times when

public confidence most needs a restorative, at which times it is free to tighten its grip to the strangle point where no exchange can be effected without the actual metal. The Bankers here are playing with an element which is outside their control and their greatest anxiety is due to this. The moment confidence in the system is shaken there is no bottom. Hoarding such as is taking place on a great scale in America to-day may bring the whole apparatus to a deadlock. To-day we stand looking over the abyss, and the depths can be gauged when it is realized that even if all the world's gold were liberated to effect the exchanges for which it was designed to serve, it could only suffice for a small fraction of the world's trade, internal and external, which we cannot estimate at less than £70,000 million.¹ It is all the more astonishing to read in an Addendum to the Macmillan Committee's Report—"The Committee decided to examine monetary policy only on the basis of the gold

¹ The imports and exports of 102 countries in 1929 were valued at about £13,700 million by the U.S. Department of Commerce. We assume the total turnover of all nations, internal and external, to be at least five times that figure. It may be mentioned that the annual income of the United States, the world's most productive area, is about eight times her aggregate import and export trade, and the income may be considered to represent the total value of the goods produced and services rendered.

standard and therefore no alternative to the gold standard was examined or discussed."

The condemnation of the gold standard, whether eked out with credit or worked purely as a gold standard, is complete. If freedom from trade, freedom from trade war, freedom from all war remains the objective, the most solid block in the way will remain so long as nations are encouraged to believe that gold is the most desirable of all the products they can import and the only form for which they should willingly exchange their products.

To-day it calls upon the Western farmer to offer for the gold dollar double the quantity of wheat that he was called upon to produce in 1910-13; it calls upon the producer of the East to pay double the tribute in silver, which constitutes his store of values, even compared with pre-war values; to sell his jute, his rice, his rubber, his copra at prices which reduce him to poverty and eventually ruin his creditors through his inability to buy their products. It has halved the apparent value of most industrial securities and thus profoundly discouraged enterprise and employment. All that it has left untouched are the first charges, mortgages, social benefits and other fixed claims, leaving the original proprietors of much of the industrial structure with only a nominal interest in their property. It has in effect demoralized the

processes of exchange between nation and nation, and between individual and individual, and not on any explicable principle but with gross unfairness to all parties. It has arrested the progress of the British Empire and even threatens to disrupt it. Could anything provide a more unhappy record of misery uselessly inflicted, bounty turned into want, honest service into cringing idleness, useful enterprise into ruin !

Thus, far from mitigating our misfortunes, the system under which we are working intensifies them. As M. André Maurois humorously writes :

“ Shall we in future rejoice at all those things that formerly made us grieve ? Shall we read some day in our daily papers, ‘ Heaven be praised, insects have devoured the greater part of the Texas cotton crop,’ or ‘ A helpful disaster. We are pleased to inform our readers of the disappearance, owing to an earthquake, of most of the Rubber plantations in Malaya ! ’ or ‘ Yesterday at Rambouillet the Minister of Agriculture had the pleasure to announce to the council that this year’s crop will be less than any recorded during the past fifty years.’ ”

But for us the issue is too serious to jest with, while the future of an Empire hangs in the balance. We have basked too long in the sunshine of illusion and to-day must plunge into the icy waters of reality. We British who led

the whole world on to the gold standard cannot remain there. Once again falls upon us the duty of leadership, of directing the world on to a sounder standard, one that will abide the test of time and outlast the ages. Service for service ; freedom to every man to develop his individual powers and resources to their highest possible extension ; a just and stable measure for the rewards of labour and abstinence ; by these and these only can we hope to reconstruct the fortunes of this great nation and its Empire on a foundation that will endure, but it cannot be achieved without big decisions and courageous actions.

We as the focus of this much vexed planet have nothing to gain and everything to lose by retaining a standard of value that is neither sound nor scientific. The world might conceivably manage with a shifting meridian of Greenwich. It can certainly not manage with the vacillations of a pound based on a metal whose control has passed from our own hands into others less responsible.

CHAPTER X

THE BID FOR GOLD

I. THE CUNLIFFE REPORT

“THE curfew tolls the knell of parting day” might well have been spoken of British trade when the Government decided in 1925 to adopt the findings of the ill-starred Cunliffe Report, which recommended the earliest possible return to the gold standard. This Committee, formed mainly of bankers and men versed in finance, took a decision based on their own relatively narrow field of survey which had repercussions they could little have dreamt of, and which is one of the primary causes—although not the only cause—that has brought British trade to the dangerous ledge upon which it now stands.

Dawn follows darkness, and the country to-day realizes its danger, and he indeed would be short of vision who failed to perceive the great possibilities which await Britain once she is alive to the sense of her responsibilities and has set her house in order.

As long ago as January, 1918, we published the following warning of the practical results

of a restoration of the gold standard based on a careful analysis which did not bear contradiction :

“ If we attempted suddenly to bring back our values to their gold parity, the result would be disastrous to trade and industry by bringing about an enormous fall in values, accompanied inevitably by tremendous depression and numerous failures. A rapid fall in values will always discourage production and thus cause unemployment, because no man will willingly create a supply of goods which are likely to result in a loss on sale. Unemployment diminishes the spending power of the community, and thus we are driven into a vicious circle in which conditions go from bad to worse ; and the very cause that would bring about these conditions, viz. the attempt suddenly to reinstate gold values, would increase the load of debt on the community, and intensify the misfortunes of the manufacturer, distributor and worker. The truth is that the restoration to gold parity can only be brought about by a gradual and natural process. As the debt is paid off the value of the pound sterling will improve automatically, and the quickest way to pay off the debt is clearly by stimulating the population to the fullest possible measure of activity. Any attempt to restore the purchasing power of the pound sterling by other means than by paying off the debt, as for example, by a drastic rise in the rate of discount, would defeat the purpose aimed at. It would withdraw from industry the very

funds that are needed to carry industry on. It would have a similar effect to the foreclosure of a mortgage or a forced sale in a moneyless market. Such a debt as we have incurred during the war can only be paid off through the energy, skill and application of our people, and cannot be paid off on short notice, however great our efforts, or however rapid the expansion in our population. Indeed, an artificial decline in trade would in itself check the growth of our population and delay the process of recovery."

2. DEFLATION AT WORK

It was unfortunate at that time that wider and wiser counsels did not prevail and that there was no opportunity for consultation with those who were responsible for the control of industry and commerce. The Treasury had no reason to press for a change, having profited through their issue of inconvertible currency by the sum of £117 millions, representing dividends from securities deposited in exchange for Treasury notes. The Cunliffe Committee were not called upon to consider the effects on agriculture and industry of the return to the gold standard. The question put to them was simple enough. By what means we could return to that standard ; and the answer they gave was a banker's answer : Deflation, i.e. withholding the means of exchange.

Within the charmed circle of monetary practice some may have perceived that the control of gold

would invest its possessors with supreme power over finance and politics. Indeed there can be little doubt that the view of the financial section of the city was that this was the road to financial and political power. They had forgotten that finance is little more than a figure of speech when the link is broken with industry and commerce. The consequences of our decision have been far more serious even than those we indicated in 1918. Indeed, the disaster is greater than anyone could have foreseen, for much more than British interests are in peril: the whole political orientation of Europe and even of many States outside Europe is at stake.

The events that followed are interesting. Obviously gold could not function so long as prices were swollen by war demand, and the Federal Reserve Board in America and the Bank of England concurred with Government economists in bringing about a drastic fall in the value of commodities. The simple expedient of raising and maintaining the Bank rate in England at 7 per cent from the 5th April, 1920, to the 28th April, 1921, accompanied by a request to the commercial banks from the Treasury and the Bank of England to cut down all credits, had an instantaneous effect and resulted within thirteen months in a fall in wholesale values by 36 per cent, the index number dropping from 313 to 200. Words

cannot describe the demoralization that ensued in the wholesale markets from this somewhat barbaric measure. Even old-fashioned houses found their resources depleted, their credit gone, and their capital inadequate to carry on trade which had taken generations to build up. To redeem goods pledged to the Bank at approximately double their reduced value was impossible, and a vast pyramid of frozen credit piled up which hampered the normal working of the banks and embittered their relations with valued clients. This also prevented the banks from extending to foreign countries, credits which had previously earned for London its reputation as the world's financial centre. This in turn put a check on exports which normally follow our loans to foreign countries, where the credits serve for the purchase of British manufactures. Foreign financiers, only too alert to seek opportunities to intercept British trade, were quick to capture a share of the financial operations once so lucrative to the London Banks, and thus secured this most valuable lubricant for their industries. There can be little doubt that Holland, amongst other countries, has greatly strengthened her financial power through these events.

3. EFFECTS ON INDUSTRY

It was a golden opportunity for America. Preserves which had long been our monopoly

were quickly invaded. The falling market at home and the losses sustained thereby materially checked initiative, leading to a curtailment of production which added to the woes of industry. Unemployment was steadily mounting and finally assumed mammoth proportions in 1921-2. The losses fell like a crushing burden on the harassed taxpayer at the very moment when the whole weight of the national debt was being heavily aggravated through its conversion to gold. The incidence of this enormous debt, it is computed, was doubled within a few years. Its effect was just as if we had to pay for the war twice over. A debt estimated on a gold basis as equivalent to £3,600 millions in 1919 was now, under the gold standard, converted to its full weight of £7,700 millions, calling for the sale of more than double the volume of produce from the producer to satisfy the tax collector. Similar conversions took place in other countries and the aggregate of war debt thus thrust upon the world in terms of gold has undoubtedly had a most puissant influence in bringing about the present crisis. We were weighing down our manufacturers with a responsibility far exceeding that borne by any foreign competitor. America was more fortunately placed. She could convert her debt to gold, for she had acquired huge wealth and, from being a debtor nation, had become the world's chief

creditor. France had written down her debts by four-fifths ; Italy by three-fifths ; Belgium by six-sevenths. The Continental nations were conscious that they could never lift their heads unless the intolerable burden of war debt were lifted or relieved.

If we had only ended there we might still have left ourselves with a task not beyond our powers, but the blindness of our political leaders with that charming optimism which is their privilege, has superimposed upon this burden of debt service an almost equal burden of increased taxation, mainly for social services. It is too often the wont of our political leaders with an airy disregard of facts, to take impulsive decisions which may pledge the wealth of generations unborn, and the temptation of winning the favour of constituents by this form of political dishonesty seems irresistible.

Gold set the pace and having so arranged matters that all values should be equated to that precious metal, we encouraged all our neighbours whose currency had passed out of hand to remedy their troubles by the now fashionable panacea : “ Adopt the gold standard.” We failed to see that in so doing we imposed upon gold a task which it was quite unable to fulfil, since its production is strictly limited and according to the testimony of experts is more likely to diminish than to increase.

Naturally the financial advisers of nations whose situation gave them a pull on gold, recommended securing as large a quantity of it as possible, until America, for example, was able to pile up a stock as large as £1,000 millions. France having skilfully put her finances in order followed suit, and it is to be noted that these two great countries are the protagonists of that exclusive policy which aims at building up their own industries so as to render them independent of foreign imports. Their interest in foreign trade is far inferior to ours, and their experience does not qualify them to engage in the world-wide banking operations which make London the pivot of finance. Had it been otherwise the only result of the absorption of gold by New York and Paris would have been a transfer of world finance from London to these two centres. Whether through policy or inexperience they sterilized the gold, and we in London know that it was this more than anything else that made it humanly impossible to work the gold standard on the smooth lines which ruled during the halcyon days of peace which preceded the Great War, a flagrant example of the power of gold for good or evil. The producer is reduced to a pawn engaged in the tread-mill exercise of growing crops or manufacturing goods to be sold as often as not at a loss, while he quietly

submits to see his meagre capital melting away until he then becomes a vassal of the bank. But we are rapidly nearing the point when banks can no longer, in honesty to their shareholders and depositors, lend any further sums to debtors who are tied hand and foot without any prospect of dragging themselves out of this "slough of despond." Could human misery reach greater depths? The situation is not unlike that which arose in Ancient Rome between the patricians and the plebeians through the pressure of debt on the lower order.

It has now become the fashion to call upon the Government to accomplish what it is beyond individual intelligence to perform, so when the credit of the bank is exhausted we organize a new field of national finance where a Government finances the farmer's crops and thus staves off the inevitable crash. Brazil sees mountains of coffee accumulate which they are reduced to destroy by fire. The Farm Board of the United States of America hold stacks of grain and cotton upon which advances have been made far in excess of their present value, creating a top-heavy position which cannot be relieved until the accumulation goes into consumption. But alas! for the disappearance of the consumer who can purchase. He has no spare cash. The stocks remain unsold. Men and women go hungry and in rags, victims of the monumental folly of

a system which no longer responds to the needs of a generation whose productive capacity has grown by leaps and bounds.

4. BACK TO THE DOLLAR

To return to our story. The resiliency of our industry is so great that the debacle of 1920-1 was not sufficient to quench our ardour, and with a national State currency still in use as initiated at the outbreak of war in spite of cramping regulations, business slowly recovered so that between 1922 and 1925 we were enjoying comparative prosperity. The frozen credits were gradually eliminated by repayment of all or part, or by writing off debts ; production had increased, exports were satisfactory, and we were weathering the storm with reasonable certainty of success. The pound steadily improved in value through the increased volume of exports and by profits secured in shipping, insurance and banking, etc., creating a purchasing power of about 17s. or 18s. contrasted with 10s. when Europe's disorganization was at its height.

Then came the blow. Government declared its intention to revert to the gold standard in order to help the pound "to look the dollar in the face," a new deflation policy was inaugurated so that values might be brought down to the gold point, which necessitated a fall of about 10 per cent. It is the last straw that breaks the

camel's back. At once trade began to wilt. Confused voices within the Cabinet puzzled the people. The Prime Minister announced that wages must come down to equalize the rise in the value of our pound, but immediately thereafter recanted, no doubt under the pressure of the ubiquitous and all-powerful Trades Unions. We need not repeat the history of the struggle which ensued, culminating in the coal strike and a narrow escape from revolution. The battle was lost, and just as surely as the Marne sealed the doom of German victory in the Great War, so the coal strike proclaimed the defeat of the gold policy. We had the choice of reducing our costs by an adjustment of wages and other charges with its concomitant reduction of the standard of living, or of losing our export trade. We declined the former and unwittingly elected for the latter. Little was it realized that it spelt the loss of British supremacy in world trade.

It would be folly to blame the public for deciding an issue, the facts of which were never clearly marshalled and set before them. Even the Press neglected the expression of divergent views which would have led to healthy discussion on a subject which after all exceeds all others in importance and in its reverberations on the life of the community. Upon an understanding of this subject depended the failure or success of British trade development, for not

all the salesmanship in the world nor all our scientific progress could save us until this issue was dealt with. Yet even intelligent people would shrug their shoulders and openly express their inability to handle a question of such paramount importance. But empty warehouses, falling exports and diminishing bank returns tell their tale. Did our bankers and politicians nurse a blind belief in our capacity to support the burdens of the world and to make good under such adverse conditions?

We append a table for which we are indebted to the *Statist*, showing the effect of falling prices on the incidence of debt. The contrast between the figures of 1920 and those of 1931 is striking.

April 1.	Net Nominal Deadweight Debt. In millions of £'s.	Interest and Sinking Fund. In millions of £'s.	Statist Index Numbers of Wholesale Prices.	Debt in Values of 1913-14. In millions of £'s.	Debt Service in Values of 1913-14. In millions of £'s.
1914 .	650	245	100	650	£24
1920 .	7,829	350	295	2,654	119
1921 .	7,574	332	182	4,161	182
1922 .	7,654	324	154	4,970	210
1923 .	7,742	347	152	5,087	228
1924 .	7,641	357	164	4,659	217
1925 .	7,598	358	160	4,748	224
1926 .	7,559	379	148	5,108	256
1927 .	7,555	379	144	5,257	264
1928 .	7,528	369	141	5,343	262
1929 .	7,500	355	135	5,555	263
1930 .	7,469	360	114	6,552	316
1931 .	7,413	355	101*	7,340	351

* Index No. for March, 1931.

CHAPTER XI

RESTRAINT OF TRADE

I. INTERFERENCES WITH TRADE

WE have seen that the limitations of the gold standard compel us to regulate production so as to keep pace with the limited quantity of currency, the supply of which is governed in our own case by our ability to find redundant gold in the world's markets for any expansion of trade that may take place. So not even the banks hold the key to the issue of currency, and with the vast changes in the field of production of the present century a hold-up sooner or later takes place. The circulation of products is impeded precisely in proportion as the circulation of money is impeded. The artificial stagnation thus engendered, not by a curtailment of human needs or human activity, but by a shortage of the media of exchange, results in a reduction of price since the producer has to force sales in order to compete for the exiguous supply.

Restraint of trade, a practice abhorrent to judicial minds as an offence against public

policy, thus becomes a normal rule of the State and is responsible for most of the ills that afflict us. Even while we congratulate ourselves on the superior scientific and mechanical appliances which have enabled farmers and industrialists to secure a vast increase of production with a smaller expenditure of energy and time, we erect barriers of every kind, to the free exchange of these products, tariff obstacles, currency limitation and embargoes. No wonder that cartels, pools and other well-meant devices are formed to counteract the effect of the inadequate means of exchange leading to the withholding of nature's products which were intended for use and not for hoarding and speculation.

Perhaps the most extraordinary spectacle of modern times is to be found in America where one department of the Government sterilizes immense supplies of the media of exchange and another encourages the withholding from the market of vast supplies of cotton and wheat, even to the point of advising their destruction. Nothing has proved more fatal to the even distribution of the world's products than this mistaken policy, and incidentally it has led governments into the field of enterprise where they have neither experience nor mandate for the task they attempt ; nor do the evils end here. The merchant, frightened by vast accumulations of coffee, rubber, wheat, cotton, sisal,

copper and other products, ceases to perform his function of buying for distribution. The rhythm of the markets is deranged. It would almost seem at times as if the world had unconsciously imbibed the Soviet doctrine of communal trade, although the Governments engaged in this practice would be the first to deny that they had had any such intention.

Not only in merchandise but also in shipping, that most intricate and technical of industries, do we find Australia, Canada and the United States of America embarking on vast programmes of purchasing or constructing lines of steamers to be put into competition with old-established shipping concerns, possessed of all the lore and experience requisite to make a success. Ruinous losses for all are the sequel. Undoubtedly the unbalancing effect of the war through the vast destruction of ships by German submarines resulted in fabulously high freights being paid to compensate owners for their risks. This was directly responsible for the artificial stimulus that led to an excessive ship-building programme and the subsequent collapse of freights. The facility of transport thus afforded could in the long run prove a benefit by cheapening freights and by reducing the time occupied in transport so as to bring consumer and producer into closer contact, but these benefits can never accrue if the monetary

machine cannot supply the necessary credits to move goods freely from point to point without let or hindrance.

2. TOWARDS FREEDOM OF EXCHANGE

The ideal union of plenty with cheapness will come when highly organized production and improved transport united with an efficient banking and currency system shall market everything produced at equitable rates. The world has, we fear, still far to travel before the nations agree to sink all their petty differences and act as a unitary whole, interchanging freely the products of tropical and temperate regions, leaving the northern hemisphere to supply us with fruits in season, and the southern to alternate during our winter. Much harm has been done in recent years by an exaggerated nationalization or by fear of a shortage of certain essential manufactures in case of war, an exclusive policy which has been too greatly favoured since the Armistice, and which results in small European States building up under high tariffs exotic industries for which they are not suitable, while neglecting the development of those for which they possess every facility and advantage.

Even allowing for national sentiment which is on the whole healthy, there is room for compromise between the more liberal policy of interchange and the economic system which aims

at making a country self-supporting in order to keep its people fully occupied in producing for themselves. One can conceive, for instance, the tropical belt of Africa proving in the future to be a vast store-house of produce available for Europe, while our Continent with its cooler climate and skilled artisans manipulates metals, textiles, and other substances that will be wanted in Africa. It is unlikely that the tropics will lend themselves to manufactures such as Europe provides with such consummate skill. Europe on the other hand can consume vast quantities of tropical products to the immense benefit of the health of her people.

3. NEED OF RE-ORGANIZATION

Development on these lines for ourselves, however, is conditional on our ability to compete on favourable terms. The United States has of late found herself unable to market her surplus because manufacturing costs were increasing, at the very time when Europe was rebuilding her industries. European production has now risen to the point when it becomes a direct challenge to our wages, and we are beginning to find that low output, indifference of the workpeople as to the quality of their work, or even to the retention of their jobs, the demoralization of the dole, the extortionate taxation, are all acting as disintegrating factors.

Transport, dock charges and freights out of proportion to those paid in foreign ports endanger our foreign trade, and recent events come as a warning that we have raised the cost of British products to a point that prevents their sale abroad. No salesmanship, however expert, will avail when cost prices are out of parity. Even were we to confine our manufacture to the requirements of the home market under the shelter of a productive tariff, we should by so doing forfeit our foreign trade and much of our power to finance the world with it.

The choice is thus a narrow one ; it is between becoming a dearer country to live in and of depending upon our vast accumulations of wealth, if we can still hold them, or on the other hand regulating wages and tasks to conform with the practice of the rest of the world.

We have witnessed the phenomenon of American manufacturers erecting plants in this country and operating them on identical lines with those current across the Atlantic. We have notable instances of British engineers accomplishing similar feats, but the textile and many other industries do not lend themselves to formidable cuts in costs. Are we prepared to sacrifice them or shall we face the problem and reconstruct at least a section of the industry on the above lines ? The newer industries, unhampered as yet by old-fashioned regulations, have made

headway which was not possible in the basic industries, where control has practically passed to the Trades Unions backed by the State through its Trades Boards and other official organizations.

4. WAGE MALADJUSTMENTS

There still remains to adjust the unfair relations between the wages of inexpert and of expert labour, and of the sheltered and unsheltered industries. Under such conditions workers are discouraged from acquiring skill by the inadequacy of reward offered.

The effect of the dole is to benefit the inexpert at the expense of the expert and to enable the former to ask more than the value of his labour. These inequalities are one of the worst by-products of an inequitable standard of values. The general level of efficiency is lowered, the incentive to do good work and to qualify for the more valuable services to the community is removed. To a nation like ourselves that depends more than any other on its reputation for good workmanship and high-class products, the consequences, if continued for another generation, may be most serious.

The disintegration already visible is alarming enough, but we have by no means reaped the fruits yet. Let us imagine a revival of trade calling for skilled recruits to all our best trades.

We shall find that the dearth of trained workers will be one of the first impediments to progress ; and we have yet to witness the worst effects on the growing generation. We may lavish money on education in the schools, but it is merely pouring water in the sands if we do not follow it up by securing fair play to the workers whose technical ability far outstrips that of the much better paid workers in sheltered occupations.

CHAPTER XII

PROTECTION AND FREE TRADE

I. THE POSTULATES OF FREE TRADE

TWO basic assumptions governed the conclusions of the economists on whose principles Cobden rode to triumph and laid the foundations of Victorian prosperity, and so long as these postulates remained true, the system then established justified their conclusions. These assumptions were : (1) that gold was a stable measure of values ; (2) that all other subjects of mercantile dealing, whether wages and salaries, the products of manufacture, the plant and processes devoted to manufacture, could be regarded as completely mobile in every sense. Commerce was regarded as nothing more than buying in the cheapest market, selling in the dearest, i.e. as a change of location, a movement from place to place, a transference in space. A transference in time came under the heading of speculation, and as such received scant consideration. It was not realized that speculation means "looking ahead" and that without some stability

in this world of mobility it is impossible to formulate the more far-seeing plans. It is not surprising that these supposedly unassailable foundations have proved to be shifting sands. If gold were constant in value and we fixed wages and salaries, rents and mortgages, buying and selling prices in an unchanging standard, the only variations that could take place would be those that were needed to regulate the supply of goods produced to the demand of the community. But supposing we fixed these factors of production at a given date, and that the value of the standard were to alter completely, as it has done, then the adjustments to be made would be of an entirely different order. Obligations entered into in respect of long term contracts, wages, salaries, pensions, governmental expenses, legal charges, bonds, mortgages, debentures, many of them fixed by law or by legislation of one kind or another, maintain a rigid value that does not adjust itself to variations in the value of gold and constitutes a solid unyielding block in the way of that rapid adaptation to changing circumstances which is essential to the working of purely Cobdenic principles. And when the volume of these first charges on production has multiplied fourfold, as it has in England (and as we can verify by comparing our national or educational expenditure with the pre-war

figure), the whole system breaks down owing to its very rigidity.

To ignore the time factor in every contract in this sense was a fatal omission. All progress, all business activity is based on anticipation. Plans must be made sometimes several years in advance and can only be worked out to their conclusion by assuming conditions of relative stability. But the best of plans will fail if the very fundamentals change far beyond the power of the designer to estimate or provide for such changes. In point of fact the events of the last few years have wrecked many magnificent enterprises, which in normal circumstances would have nobly contributed to the progress of the nation and promoted that very adaptation of the national economy that was needed to bring it into line with modern world developments. And even the most cautious banks and other financial institutions have found themselves tied up in consequence. The results are serious indeed—the extinction of that very spirit which is the necessary condition of success for free dealing. In other words, the two principles cited, mobility and stability, have each their sphere of action in every community. We may liken their action to that of an express train travelling on an iron road. If the rails are unstable or the engine too loosely constructed mobility becomes disaster. If the rails are

stable mobility reaches its highest expression. In the political sphere the principles of conservatism and liberalism embody much the same alliance in every healthy State.

2. THE GOSPEL OF CHEAPNESS

To each generation comes its own responsibilities, not to be solved by those who went before nor by those who follow after. The older economists could never have foreseen the amazing changes of the last hundred years. They formed their conclusions on things as they were. They found themselves in a community where the tools and machinery of industry were relatively simple and inexpensive ; where trade was conducted with difficulty, for the means of communication were incomparably inferior to our own. Succinctly stated, there was much less mobility in commerce and much less need of rapid adaptation to new circumstances on the part of the human element. There was greater natural stability for the village worker who was closely knit up with his environment. Indeed we can judge this from the very character of the people. Life was hard, the strain longer although perhaps less intense, which gave an air of leisure to their actions. If the best was to be made of such circumstances every effort had to be put forward to liberate trade from the shackles

that might be imposed by government action. Furthermore, the idea of regulating wages and forming trade unions for the protection of labour was still unheard of. Wages were fixed by the pressure of population on the one hand and the lust of gain through exploiting cheap labour on the other. Since there was free trade in labour it followed that any restriction that would interfere with the satisfaction of the needs of labour would prove an injury both to the worker and employer. Freedom for all to buy in the cheapest market was the inevitable corollary.

In such an environment the views of Cobden naturally proved to have undisputed force. England built her whole economic foundation on these principles and prospered on the freest possible dealings between man and man. The old school of employers held out tenaciously against any interference with this freedom. Trade Unionism was cordially disliked, but the public conscience was not satisfied with the abuses that arose from such a system. The lot of the workers, left to the free play of economic forces, however productive of wealth in its material form, left too much to be desired by any higher test. Men like Ruskin inveighed against the brutality of it all. The weaknesses were too apparent to be tolerated, and reform succeeded reform till, as at the present day,

the life and welfare of the worker have become a first charge on the national wealth, unrelated even to the worker's productive capacity. It is better, indeed, it was now argued, that an industry should perish, however important, than that the standard of living of its dependents should be degraded. But it was not merely in this direction that the earlier conceptions were breaking down. The older order which provided a fertile breeding-ground for the individual type of employer was giving way to a new. The smaller unit applying itself independently in a strictly circumscribed sphere of action was now beginning to feel the strain of fighting against larger organizations covering a wider field of activities. Vertical and horizontal combinations, as they are now called, were growing up, of which we have types in the cotton industry of Japan and in many of the Continental organizations. England was now exposed to the full blast of international competition untempered by the natural barriers of distance that had virtually been annihilated. Big organizations, expensive plant would flourish, but not under the old conditions. The problem had to be reviewed in a new light.

3. MASS PRODUCTION

The founding of an industry in these times may entail the erection of plant and buildings

on a scale which would have terrified our ancestors, to whom the possibilities of mass production remained unexplored. They enjoyed a stable foundation for their labours in the preference of their neighbours for the personal products of their skill. Local customs were strong and the demand strongly individualist. These conditions have largely been swept away. From West to East human tastes and preferences tend to be unified. Tokyo and Tomintoul equally succumb to the cheapness of standard machine-made goods. What is worn in Paris or London becomes the fashion in Rejkavik or Fiji. It is once again the big battalions of Napoleon that win in the field of commerce. But to lay down the organization able to deal with trade on such a scale there must be a strong foundation to build upon, and the choice seems to lie between industries built up like the British film industry under the protection of the State, or the narrower fields of high craftsmanship perfected beyond the reach of imitation. The castle walls no longer serve. Industry looks now to the reservation of as large a trade area as possible, whether by protection or treaties.

America was quick to learn the new doctrine based on the law of increasing returns. You may build your establishment for a standard production of a given size with your market

guaranteed for you against all outsiders by a tariff wall. But trade never flows in a steady and uninterrupted volume. That is not nature's way. There are periods of flood and periods of ebb-tide. There will at times be an unwanted surplus and you must maintain a stable price for your product by any means you can. Stability can be bought by shifting your surplus freely to another market. You fix, as the railway companies do, "the price that the traffic will bear." Your productive establishment, which we may sketch thus :

Production Based on Establishment Costs	Production Free of Establishment Costs
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is already paid for. The cost of any further supply is little more than the labour and material. If it is wanted at home it can be marketed without lowering your market there ; if it is not wanted at home it will be more profitable to dump it freely elsewhere at prices which have no relation to establishment costs rather than injure your own market ; and no smaller organization can fight against you either on your own or outside territory. Your operations may extend till your rivals, crushed and despairing, abandon the struggle and leave you to

include the new terrain within your own. Such is modern commerce !

“Timeo Danaos, et dona ferentes,” said Virgil of old. “What !” say some. “Are we to look askance at those foreigners who are thrusting gifts upon us. At least they must take something from us in exchange at an honest price, and then we shall have the best of the bargain.” If it were only so simple all would be well, but alas, it is humanly possible at times to *buy present gains by future sacrifice*, and it is worth while tracing the sequence of events that may conceivably follow, and does follow in many cases ; the loss of capital due to the closing of expensive organizations, the disbandment of skilled and trained labour, the call for gold to pay for the imports, the consequent rise in the Bank rate, the resulting check to national industry, the calling in of loans, the choice of emigration for those displaced and the best blood drifting away, or the dole for those unfit for new adventures. Idle machinery has no value : it means capital destroyed. Idle workers have no value : they mean life wasted. It is not now as in a former century when wages under the stress of uncared-for unemployment would rapidly accommodate themselves to the need of export, and new tools, new avenues of employment could be readily found. Rome, too, relied on her *dona ferentes*. The tributaries satisfied

her needs and fed her hordes of idlers till the seat of her power was sapped and a mighty Empire was riven into fragments.

The future development of trade tends more and more, as in our Empire, to become a matter of mutual bargaining in which the self-interest of each country stands paramount, the larger areas tending, as in diplomacy, to acquire the greater influence. Yet to bask in the sunshine of free imports seems so alluring. We all like sunshine ; let us have it without limit ! Yes, but your prudent housewife regulates its entry to her home. Even our eyes are constructed to admit no more than is necessary to our vision, lest the delicate mechanism of the eye be destroyed. So, too, the miller building a mill-race takes every precaution that the flood waters shall run to waste to avoid endangering his machinery.

4. ECONOMIC SELF-DETERMINATION

In truth the controversy between Free Trade and Protection has lost much of its point. All a tariff can accomplish in the last analysis apart from its tax-raising value is to determine for better or worse the form that the activities of a nation are to take and to direct the form in which it shall receive a return for its exports. Cheap food and raw materials stand in the forefront as desirable for a highly industrialized

nation. In freeing these from taxation we are in effect putting a premium on imports, since home production cannot avoid its share of national taxation ; and Britain has accepted the sacrifice of the home producer in these classes as the price of industrialism. But no nation will ever willingly surrender the right of self-determination in this respect despite all the theoretical advantages of free trading, least of all the United States where protection is carried to its highest pitch in conformity with the traditional insularity of that great people. To them has accrued an unforeseen advantage since the war reversed the rôles of debtor and creditor between Europe and America. By blocking the entry of manufactured products and insisting on payment in gold, America can drain the world of gold, depress the value of produce and force up the quantity that Europe must find to satisfy her demands, a method of self-enrichment which the older economists could scarcely have foreseen, with all its danger to the world's economic structure.

The past century has proved, in truth, that neither by demonstrating the advantages of free interchange of products nor by our example, have we ever dissuaded any nation from the policy of regulating its imports to suit its own interests either for the sake of its national industries or for the purpose of raising revenue.

But there will always be one great restraint on unwise protection, viz. that no nation can prosper that raises its costs of production by devoting its energies to unprofitable pursuits. This is a practice, however, which is not confined to protectionist countries. The most wasteful of all dissipations of energy is our own unemployment, and there are many other questionable activities of the State, forms of expenditure indulged in without consideration of the adequacy of the return, which like undesirable road expenditure, have evoked frequent protests from the public. Under present conditions the gold standard decides the valuation of every nation's production, and no nation by any act of its own short of an actual production of gold, can raise that valuation. Thus any action, however well intentioned, that tends to raise the cost or to reduce the efficiency of a nation's production must be injurious to the welfare of all. In plain terms, no nation can tax itself into prosperity ; and perhaps this is the strongest argument against protection. It will avail us nothing if we do not provide the media of exchange to compensate for the higher level of prices for which it is designed. At best it can favour one section of the community by the sacrifice of others. Under what circumstances such sacrifices may or may not be justified must be reserved for later discussion.

We may, in closing, pay deep respect to the pioneers of Economic Science who laid the foundation for us of a great industrial era ; but nothing remains constant in this world of flux, and they, least of all, would have disputed the instability of human affairs or the immutability of their conclusions. We are all at school from the moment we are born till the day we die, in nature's hard school learning under the guidance of a Providence which does not scruple to destroy those of us who prove refractory to her processes. Adherence to old formulae, resistance to change will serve us no better than the counsel given to Canute by his foolish courtiers. We can never be absolved from the duty of working out to their conclusion the problems of the day in the light of each day.

CHAPTER XIII TAXATION

I. THE PROVINCE OF TAXATION

THE needs of our social order demand community of effort in many directions, and indeed this has led to the theory that all human activities can be brought within the orbit of a communistic state on the principle of "all for all," with the interests of the individual completely subordinated to the service of the State. Without going to the latter extreme, which is now being tried out in Russia, we have each and all of us to accept a duty to the State as the price of the freedom we claim to do things in our own way and to suffer, prosper or endure in terms of our own personal experience. This duty has always taken the form of service of some kind or another to the governing organization, whatever it may be. When all alike share in the protection of the State and all stand to benefit by it, self-interest brings willing service, and that service takes the form of assigning to the State a portion of one's gains. In following the development of taxation

in England the sense of willing contribution has always prevailed. The House of Commons, representing the people in conference, votes to the King the means he requires to carry on the functions of the State. The King's own levy is resisted and unjust taxes excite revolt with, sometimes, far-reaching consequences, as in the secession of our American Colonies. In such a spirit of voluntary sacrifice direct taxation of income has been elevated in Britain to be the main pillar of our system of raising revenue, and the loyalty and law-abiding character of the British people have proved that they will endure sacrifices in this form even when they reach the point of endangering the economic structure. The merit of it is that each contributes according to his ability, or in proportion to the blessings that Providence has showered upon him ; and to this end we have carried to a fine art the graduation of income tax and surtax. In this respect we have set an example which has been followed by most other nations. But this is not the only method of contributing to the service of the State. The nation may take a toll at the moment of transference of goods or services to the buyer or consumer. We see illustrations of this in stamp duties and in the customs and excise taxes. France has also a turnover tax. All the latter we may call consumers' taxes and within this description it is legitimate to include

a certain proportion of so-called registration taxes such as the registration of motor vehicles, which is designed to fall upon the consumer.

There is a third form of taxation in this country which has proved to be a very valuable adjunct for the Chancellor of the Exchequer. The death duties are founded on the principle that the succession to an estate represents a "wind-fall" for the inheritor in which the State may take a generous share without injustice to anyone. This system of taxation has been carried further in Britain than in any other country, and to those who look to taxation as a means of redistribution of wealth, this and the direct taxes make a most alluring appeal, and cause them to overlook certain fundamental principles from which no system can deviate without peril to the whole economic order.

The ultimate effect of all taxation is to transfer the right of expenditure from the hands of the private citizen to those of the State. If this right is not successfully transferred we have conditions such as prevailed in the Great War where the transfer of spending power was largely fictitious. The public in many cases, far from moderating their demands, increased them ; and the State, buying against the competition of private demand, was unable to restrain the upward surge of prices. If we wish to restrain the consumer from spending we must, if we can,

exercise our restraint at the very moment of his expenditure ; and from this point of view the turnover tax and all taxes of this nature are ideal. The consumer of petrol, sugar, beer or whiskey is fully conscious when he buys these products that he is contributing his share to the State by the personal sacrifice of receiving less for his money than he would otherwise be entitled to. He may not reason out " In giving the State a share of what I am spending I am providing for the sustenance of the men who will build a battleship and the crew who will man it," but that is the sum and substance of the bargain.

2. DIRECT TAXATION

The direct taxes stand on a different footing. Either there is a tacit assumption that what a man earns he will spend ; or the fact is disregarded that profits that are reinvested are of capital benefit to the whole community. In actual fact the income tax and surtax include in their sweep not only the funds available for expenditure, but also the funds available for saving. The Chancellor of the Exchequer is thus in the position of a croupier who, not content with raking in the share that falls to him on the gaming-table, is gathering in stakes that are placed on the table for a new deal. The effect is naturally calamitous for the country itself, as the flow of money available for invest-

ment is dried up before it can enter the market, and it is worth noting that without exception those at the centre of the financial machine complain of the complete lack of enterprise that now prevails. But without going to these authorities it is sufficient to turn to the figures of unemployment. It has been estimated that an average amount of £400 is needed to give employment to an industrial worker. Thus capital and employment are complementary terms. We have now a deficiency of employment of nearly three million people, implying a deficiency of capital of £1,200 millions. Is this a measure of the destruction wrought by a system of taxation that ignores the fructifying power of capital?

It is when we come to examine the details of our system of direct taxation that the evils stand out most saliently. The following table was prepared by Mr. D. M. Sandral for the Royal Statistical Society and indicates the burden of taxation on the larger estates during 1930-1 in the case of investment income.

Income.	Income Tax and Surtax.	Provision for Death Duties.	Stamps.	Total.
£	£	£	£	£
5,000	1,313	920	50	2,283
10,000	3,513	2,563	100	6,176
20,000	8,638	7,553	200	16,391
50,000	25,638	32,319	500	58,457

Provision is made here by insurance for the death duties and it is assumed that the taxpayer

is married and has three children under the age of sixteen.

It will be seen that the largest estates cannot even attempt to make provision for death duties and even with the lesser estates the toll assumes the nature of confiscation. The principle of confiscation has been frequently applied in Eastern countries and even in times of civil strife in our own country, but wherever it is practised, experience shows that all progress is arrested. The State that resorts to it is destroying itself, as can be seen in some of the more backward governments.

William Ewart Gladstone, who was certainly one of the greatest of our Chancellors of the Exchequer, held firmly to the view that money fructifies best in the pockets of the people, and until the war an income tax of 1s. in the pound was looked upon as a heavy burden. Was Gladstone right? If the capitalized cost of sustaining one man or woman in unemployment be estimated at £800, which corresponds with an average expenditure of £40 per head (rather less than the actual amount spent), apparently for half that sum individual enterprise could set him free from the demoralizing influence of the dole and return him to useful labour.

So completely has this aspect been lost sight of that the reserves of public companies, which must be regarded as provision for future development, are treated as fair game for the Inland

Revenue. Sir George Touche estimates that within twelve years the Inland Revenue drew £600 millions from funds placed to reserve by public companies. As he says, "the exaction of this sum belongs to a policy which breeds unemployment."

But the mischief does not end here. Under the intensive competition of modern times, machinery and even buildings fall quickly out of date, and in order to maintain efficiency values have to be rigorously written down as rapidly as possible. But at this point the Inland Revenue steps in. Depreciation is rigidly curtailed. An allowance is granted that is wholly inadequate, and companies are thus driven to maintain obsolete plant at figures which have no relation to the real value until finally the whole is closed down. No allowance is made for appreciation in the value of currency which brings a rapid fall of values ; and machinery may thus stand in the works of a company at many times its real value. A balance sheet under such conditions becomes entirely fictitious. Amounts called upon to be declared as profits may in reality be losses ; but from the Inland Revenue point of view they must pay their share to the Exchequer.

The effects are of course disastrous in times like these when every inducement should be offered for fresh capital expenditure to renew plant and increase efficiency.

Another feature of this form of taxation still further aggravates its destructive qualities. We have shown that the returns on business enterprise vary with the risk. Thus an enterprise which is started with an even chance of succeeding or failing should, if and when it makes good, yield double the amount due to an investment in gilt-edged securities. In point of fact, figures published by the *Economist* suggest that the average return on successful industrial investment should be somewhere about 10 per cent. That does not mean that the average industrial investor makes 10 per cent. Far from it, as every investor, great and small, has reason to know. He may be lucky if he makes 5 per cent when he writes off his losses.

Now the actual levy on an income of £5,000 with surtax included is 5s. 9d. in the £. The successful investor who reaps £10,000 on an equivalent investment pays 7s. 2d. in the £. If with still greater risks his return should rise to £15,000 the levy would become 7s. 11d. in the £. But enterprises that fail are of no interest to the Inland Revenue. They bear their own losses, the capital disappears and they go into liquidation. As the Government is only interested in success, its share in the proceeds of success rises with every increase of risk, a direct discouragement to any new venture, bearing an unpleasant resemblance to the old catch, "Heads I win, tails you lose."

The results are obvious. Safety first pays best, and the danger of that is the extinction of the spirit which creates an Empire. The large amounts of capital now held on deposit account are an ominous sign.

3. TAX ADMINISTRATION

The administration of the income tax is worthy of a loyal body of officials. No pains are spared to make the best of the system, but there is little or no elasticity in it, too little of that free play which might in better circumstances ease the weight on the backs that bear it. The machine drags along at a cumbersome pace so that claims may be formulated long after they are due, when the circumstances of the taxpayer have completely altered ; and men who have lost fortunes may find themselves confronted with claims which under their reduced circumstances may take a lifetime or more to extinguish, or which can only be met by sacrificing capital. The officials themselves are not only aware that the so-called "income tax" is being recovered by the destruction of capital ; they may even urge the harassed taxpayer to contract debt for the satisfaction of their claims or beg him to resort to other expedients which are diametrically opposed to the interests of the State. The method itself is not inquired into, nor are the consequences of the pressure too closely

scrutinized. If there is any principle of taxation that should never be infringed it is that of gathering the tax before income is transmuted into expenditure. Even a day's delay after that may convert any tax into a vicious and destructive impost.

It is worth noting that even in the most recent Report of the Commissioners of Inland Revenue £1,670,000 is shown as collected in respect of excess profits duty and munitions levy ; profits which presumably were earned during the war period or immediately after. The collection of these at this late date, years after they were earned, can only have been made possible by capital liquidation enforced at a time when the burden has increased many fold through the heavy fall of prices since 1920.

The Exchequer even reports the receipt of £580,000 from the long extinct Corporation Profits Tax, a testimony to the pertinacity of the officials, if not exactly to the wisdom of the executive.

The last and most destructive stage of taxation comes when we part company entirely with the spirit of voluntary sacrifice on which the income tax was founded, and which still regulates our actions when we weigh the extent of our indulgence in beer or tobacco. When the taxpayer has to be driven by threats of imprisonment one of two things must be assumed : either he is a determined lawbreaker, endeavouring to escape or evade the honourable ser-

vice of the State, or the tax has passed the limit of prudence or reason through change of circumstances or some defect in the tax itself and has become a danger or an injury to the taxpayer, evoking the passive resistance of a John Hampden or that more active resistance of the Boston Tea Party which so completely changed the course of our history. Unfortunately the machinery for distinguishing such cases is somewhat inadequate. The Commissioners of Inland Revenue are accustomed to examine each by reference to reports from the department. They are in a very difficult position. In dealing with hard cases their actions would naturally be governed by the same care and discretion that a prudent gardener exercises who, living by the fruit he gathers, is vigilant not to destroy the trees that yield him his increment. But unfortunately the urgency for funds of each successive Chancellor of the Exchequer tends to exceed by far the discretion of the collectors, or the capacity of their clients to pay. The difficulties of the Inland Revenue may be realized by the fact that out of those unfortunates who to-day suffer under the obnoxious practice of imprisonment for debt (which in English law still lingers under false colours as "Contempt of Court"), a large proportion consists of tax defaulters. With the million or more added recently to the roll of income-tax

payers, the Inland Revenue Commissioners may well draw back with horror at the prospect of fresh hecatombs of victims to be offered on the altar of Financial Rectitude even if they were indifferent to the invasion of homes, the destruction of family life, the pressure on courts and prisons, and the terrible consequences in all directions that might ensue ; for even the threat of these things has unhinged many minds reduced to despair by misfortune.

4. THE DEATH DUTIES

If the vices of the Income Tax and its satellite, the surtax, are so serious, what are we to say of the Death Duties ? In this case there is no question as to their nature. They are nothing else but a capital levy in all its nakedness because the State immediately proceeds to convert its inheritance into cash (although the burden of liquidation is thrown on the estate) and then spends the money so acquired. The State as an heir, in fact, behaves exactly like a spendthrift, and we can trace the effect as clearly as that of any other spendthrift.

We may begin with the inverse process of which the *Westminster Bank Review* of January, 1931, gave us a useful summary. It shows that if money is saved to buy existing stock, the result is a transfer of buying power to the original stockholder. He in turn will reinvest his capital,

and, however many hands the money passes through, the ultimate effect will be to increase the capital resources of the market and to create a demand for producers' goods employing those very classes of people like steel workers, ship-builders and locomotive builders, who are at present suffering most from unemployment.

Now our spendthrift comes along and reverses the process. He sells his stock, but does not reinvest the proceeds. He reduces the capital resources of the market, contracts the demand for producers' goods and throws men out of employment. True, his wastefulness gives fresh employment in another form ; but instead of increasing production and thus bringing down the price-level which would facilitate export, he is adding to the competition for existing goods, raising the price and creating an obstacle to export. The death duties, as now administered for the purposes of expenditure, could only be justified on the theory that if the State were not the spendthrift then the other heirs would be ; an argument too dangerous to admit of discussion ; and the plundering of the largest estates becomes sheer destruction.

It is time that the nation realized that taxes collected on capital have to be paid back at usurious rates in unemployment, and that every budget made on these lines is an invitation to bankruptcy. The facility for raising money in this way has merely encouraged extravagance.

CHAPTER XIV

TAXATION (*continued*)

I. A COMPARISON

IT is frequently said that we have reached the limit of the taxable capacity of the British people. Such a statement is really far short of the truth. In all directions the British system of taxation has been converted into an instrument that is destructive of the capital of the nation, and we do not need to look further for evidence of this than the two most conspicuous phenomena—

1. Chronic and incurable unemployment.
2. An internal price-level out of relation to the gold standard as tested by the index number of wholesale prices.

Both these phenomena suggest that our consumption is out of relation to our production and both are conspicuously absent from the economy of our neighbours in France. Yet the French people are the most heavily taxed in the world, next to ourselves. Even now, in a time of incomparably bad trade, unemployment is not serious, and subsidized unemployment scarcely exists in France.

Here is a comparison of the price-levels, wholesale and retail, to show the relation of the two in each country.

	Percentage of Pre-war, U.K.	France.	Excess, U.K. over France.
Wholesale . .	93·1	91·0	2·1
Retail . .	141·0	121·0	20·0

We shall now consider the essential differences between the French and the English systems of taxation.

A comparison of the French and English budgets yields some striking contrasts, but before examining these we must consider the principles which lie behind both. We have shown that the purpose of all taxation must be to transfer spending power from the hands of the individual to that of the State. This implies certain elementary principles which we may set out in this form :

(1) The effect of the tax should be to restrain the consumer from spending, not the producer from producing.

(2) A tax on capital is necessarily a tax on production because it destroys the tools of production.

(3) A tax on savings is also a tax on production because they are potential capital and no nation can progress that discourages thrift.

(4) The restraint on the consumer must be

felt at the very moment where his expenditure is in question.

The last point is very important, because if there is any defect in the British system it is that it does not bring home to the average voter the effect of Government extravagance. It is too frequently assumed both by claimants for benefit and by those who raise revenue that "the other fellow" foots the bill; that the supposed super-abundant wealth of the wealthy constitutes an inexhaustible purse from which the free and independent citizen has the right to draw generously for every scheme of public benefit, real or apparent, that his wit may suggest to him. If therefore a tax is to come home to the citizen it must hit him precisely at that moment when he asks himself, "Can I afford this expenditure?" That makes it personal to himself as an outlay of the State. The choice is "who shall spend, I or the State?"—and that is a healthy state of mind. The danger of any other course is that of divorcing responsibility from power and privilege, to which the demagogue lends himself so freely with his shrill cries of "Hands off the standard of living" or anything that touches the pocket directly. The "ninepence for fourpence" spirit is unfortunately deeply rooted in the human race and it takes a good deal of courage sometimes to suggest that it may ultimately end in "fourpence for ninepence."

2. AN ANALYSIS

In making a comparison of French and English taxation it is necessary to consider three broad groups which we will summarize thus :

1. *Taxes on turnover.*

In these are included customs and excise, stamp duties, motor duties, duties on colonial products, taxes on sugar, petrol, matches, salt, and (peculiar to France) stock exchange tax, turnover tax and luxury tax. All these necessarily come home directly to the consumer.

2. *Taxes on the profits of business.*

Income tax is common to both countries, but England specializes in surtax or supertax, and still collects excess profits duty and corporation profit tax.

3. *Taxes on capital or transfer of capital.*

Estate or death duties, registration.

In addition to these, a proportion of the British revenue is derived from property or loans.

It will be seen that France collects over two-thirds of her taxes on turnover, while we collect nearly two-thirds of ours on profits, the liquidation and transfer of capital or receipts from loans and property. In France the consumers'

BRITISH AND FRENCH TAXATION

Financial Year 1930-1.	Britain. In millions.	Per- centage of whole.	France. In millions.	Per- centage of whole.
<i>Taxes on turnover (in millions)</i>	£ 283.3	35.5	£ 184.4	68.2
<i>Taxes on Profits</i>	327.5	41	29.0	10.7
<i>Taxes on Capital or transfer of capital, including Stamps and Registration</i>	119.2	15.0	57.1	21.1
<i>Revenue from Property or Loans</i>	68.5	8.5	—	—
 Total (Post Office revenue excluded)	£798.5	100.0	£270.5	100.0

tax predominates. In this country the taxation of capital and income.

One may admit the limitations of the former system. France was quite unable after the war to collect taxes that were in the least adequate to the burden of debt incurred during the war. The French people, however loyal, are realists in this respect. They live carefully and pay out grudgingly. Their experience of income tax was limited and the machinery for collection is far inferior to our own. Of the Frenchman, even more than of the Englishman, it may be said that the people will never pay more than they can willingly spare. In the result the public opinion

of France, as represented by the views of M. Poincaré, fixed a value for the franc which gave foremost consideration to the industrialist and was rather less than fair to the rentier. That indeed meant a capital levy which affected all holders of fixed interest-bearing securities and favoured all borrowers, including the industrial classes. But the rentier's sacrifice ensured the activity of industry ; and finance is, after all, a product of industry. We who sacrificed industry now find that without it finance cannot stand, and the Bank of England could not meet the pressure of the German Crisis, nor our own.

The French rentier suffered, but need he envy the deadly efficiency of a system like our own that consumes the very framework of the nation ?

3. EFFECTS OF TAXATION

It is clear from this examination that the people of France have set their faces against the taxation of the producer or his capital. A tax that falls on production is bound to react unfavourably on the community and to engender unemployment. Lord Colwyn's Committee which sat to consider the subject of the National Debt and the incidence of existing taxation on trade, industry, employment and national credit, reached the rather surprising conclusion that "the burden of direct taxation does not with

trivial exceptions enter directly into prices, and its indirect effects are not such as substantially to affect the general price-level." The conclusion apparently was that it represented a mere transfer of *spending* power to the government at the expense of the taxpayer; that the total demand for goods and services was neither increased nor decreased and the supply equally unaffected. There is a tacit assumption here that the taxpayer's money if left to him will not be used for other purposes than expenditure, which is a direct denial of Gladstone's view, although it stands to reason that the more a man's surplus is depleted the less will he have for investment. The lesson is driven home by facts.

We have to go deeper than this however in our analysis. Obviously the more pensioners, unemployed persons, social beneficiaries, supernumerary officials, and other unproductive or not directly productive dependents a nation carries as passengers, the fewer are left to sustain the burden. The process of impoverishment moves with gathering momentum because each person who passes from the one class to the other "counts two on a division." The nation's production falls and that fall means a higher cost of production. Its effect on the export trade is even more marked because the exportable surplus is only that proportion that can be

spared after the home needs are supplied ; and a fall of 10 per cent in productiveness may cause a shrinkage of two or three times that amount in export. These figures are indeed confirmed by the facts. The decline in our export trade has proceeded lately very much faster than the decline in our imports, and if we are not living on our capital we are at least no longer accumulating any, a serious matter for a nation of financiers.

We need hardly detail the mechanism by which heavy Government expenditure finds its way into the price-level. Enough to say that if savings are depleted interest rates keep high, capital is harder to find, enterprise is discouraged, production falls, but not the number of mouths to be fed ; and the competition for a smaller supply drives the price up. At this point, however, the British people say “ No ; if prices rise at home we shall import what we want from abroad and that will bring them down again ” : and so the tax can be forced directly on to the producer, leaving it to him to cut his costs accordingly. What are his costs ? Interest on capital already determined by the heavy demands of Government for money, and tending to rise still further owing to the strain on the money market to meet the costs of unnecessary imports ; wages rigidly held at a fixed level by the action of Trade Boards, Trade Unions

and unemployment pay, profits already cut below the point of safety, where they have not disappeared altogether or been turned into losses. Well, the fruit of that is obvious enough. What is the value foregone when a million acres of fertile territory go out of cultivation : what is the loss due to 100,000 men turned from the land ? These are merely instances of a general tendency.

4. CONSUMER OR PRODUCER

So we have to realize that the tax which falls on the producer and which can be evaded by the consumer is as destructive of national wealth and well-being under the conditions stated as if heaven were to rain bricks indiscriminately on our cities. Bricks indeed are good things, much needed for our comfort, so long as they arrive when and where they are wanted, but not on our devoted heads to our own destruction. The solution we seek for our trouble by buying unrestrictedly from abroad tends merely to draw on our capital reserves and to destroy our men, plant and machinery by reducing them to idleness. And what is the value of idle plant ? A distinguished accountant once declared that however great the expense might be of creating costly plant and equipment, if it could earn nothing it was worth nothing, and any other view was illusion.

So we are brought back to the consumer ; and the only way that we can bring his duty home to him and counter-check his evasion is to tax the product he buys from abroad so as to bring it into equitable relation with the goods produced at home under the restrictions that the public itself fixes in order to secure the standard of living which it regards as its birthright. The consumer has then won the right to regulate his own household, for he is paying to do so. He can fix the conditions under which goods are to be produced, the hours of labour, the class of workers to be employed ; but he must not forget that the standards he fixes will determine the volume of goods that he exports and therefore the volume he can buy from abroad. If he overrates the value of his services the consequences may be concealed for a while in a nation that has capital resources to draw upon and an increasing return in kind through falling prices ; but the end will only be delayed, not averted ; for in the last resort all trade is of the nature of exchange, value for value, and trade on unequal terms breeds its own doom.

CHAPTER XV

UNEMPLOYMENT

I. ABORTIVE REMEDIES

WE have traced the genesis of unemployment to those causes which operate to destroy individual enterprise. Even if led by what Mr. Bernard Shaw calls men of impressive ability and unprecedented freedom of thought and supported by a ruthless, disciplined and well-armed body of fanatics, no Government, no corps of officials can ever create a satisfactory substitute for the free working of the independent spirit under its own individual responsibility ; for no one human mind is capable of all the arts and all the graces, nor can any man, however intelligent, predict how, when or where will be evolved the types that are wanted for each successive generation and which indeed flourish best under conditions of perfect freedom.

We have shown, too, that our system of taxation is destructive of enterprise. We may now turn to consider in detail why all our efforts to remedy unemployment have resulted in failure. We have a longer experience than any other

country, but our failure has proved to be a warning to other nations of "how not to do it."

At the start it must be obvious that merely to take money from Smith, Brown and Robinson and pay it to Saunders, who is out of employment, provides no solution. The money contributed by the three former was in point of fact potential employment, before it passed into the hands of the State and in the process it has inevitably suffered some alteration at the hands of the officials. We are therefore creating at least as much unemployment as we pay for, and it is a noteworthy fact that despite all the changes that have taken place in the details of the unemployment register, the total has always preserved the same general character. Clearly the effect of the dole is to withdraw labour from the market and to make the wage-level irresponsible to the gold standard. This is brought out by the events that have succeeded our return to gold. With each fall in values and with each increase in the real value of the dole which has, indeed, been a gold wage for idleness, the numbers of the idle increase. We are, in effect, bidding a higher price for idleness, and we get, as we might expect, an increased supply, showing the intimate connection between what we pay and what we receive in exchange, which is expressed in the law of supply and demand.

Is the insurance principle unsound then? Not really. It is founded on the conception that all trades are subject to seasonal and cyclical variations. A certain labour force is necessary therefore, and must be maintained for the healthy functioning of industry, for if the labour force were disbanded, it might prove a costly process to build it up again. Thus there may be greater ultimate economy in carrying a reserve for the sake of the stability given to the trade. Here lies the weakness of the "Free Trader's" case. He overlooks the gain that may accrue to industry through regulating competition, a principle which is held to be in the public interest in the transport industry. It is illustrated by the case of a cab rank. The service of the public demands that there shall be vehicles sufficient for its reasonable needs and that the return on the industry shall cover the idle periods. A tariff is therefore fixed which does not admit of variation by competition. A great element of judgment enters into this process, but once the tariff is established supply and demand follow their natural course. Cabs will drop out of the rank as they find their return inadequate to cover their periods of idleness or will enter the rank if the public service calls for more.

But here is where our troubles begin in the State unemployment scheme. This element of

elasticity disappears. Each industry has its register of workers fixed and immobile. There may be an unsatisfied demand for domestic servants and a superabundance of hotel servants. Everything being in “water-tight compartments” we have a state of rigid stability which cannot be reconciled with those ideals of rapid adaptability that are proper to a Free Trade system, and even if our scheme could be harmonized with the Free Trade principle in respect of temporary variations in trade, it fails when it comes to secular changes and therefore leads to the permanent sterilization of labour. New trades starting up may find an actual scarcity of workers while older trades become more and more “waterlogged,” with an unwanted labour force, for which there is no hope of employment. To return to the parallel of the cab rank, if the law enacted that an excessive number of cabs must be kept on the rank, the excessive period of idleness enforced on them as a whole would necessitate an unduly high fare, which would still further reduce the amount of trade before equilibrium could be attained, with the added risk of inviting other forms of competition which might finally leave them “high and dry.” Had our unemployment scheme been initiated on such lines in the days of stage coaches, we might still be carrying a dying industry at the expense of the public,

and the progress of transport would have suffered in all directions.

2. THE SOUL OF BUSINESS

Events have proved that nothing can take the place of the element of private judgment which decides for each industrialist the reserve of labour that he can safely carry without adding to his costs. In point of fact, every business house is accustomed to carry a slightly larger staff than is immediately needed so as to allow for the elasticity of demand and provide for possible expansion. All through business similar delicate adjustments are daily made as a matter of course, depending on a specialized knowledge of the circumstances pertaining to each case. Here, in truth, is the soul of business. The bank manager has daily to estimate the demands for cash that may be made upon him. The railway traffic manager has to estimate the probable demand for passenger accommodation on each particular day ; and the profit or loss of the company depends on the success with which he reduces the unused accommodation to a minimum.

The unemployment scheme seeks blindly to solve the whole question without any of those delicate adjustments based on personal experience, and hopes to replace them by purely mechanical substitutes. Let us suppose that our Government had applied themselves to the busi-

ness of traffic management on similar lines, and that in order to secure seating accommodation for all passengers, they had agreed to pay the railway companies a remunerative figure for all seats not occupied at a standard price. We can imagine that from that moment the traffic managers, relieved of responsibility, would habitually and cheerfully over-estimate their needs. That is the danger of all such schemes, personal responsibility of every kind is eliminated, and the abuses on the part of both employer and employee find a fertile soil in which they can flourish like weeds.

At bottom that is the weakness of the whole Socialist case. It seeks to relieve the individual of responsibility, whether that of rearing his children, of finding employment for himself, of shaping his career, or of providing for his future. It assumes a static condition of society which the officials take over as a whole and which will remain static for ever. Perhaps that is why War to the Socialist is unthinkable. It upsets all his calculations. Socialism must be universal to succeed. It must eliminate the struggle for existence which is peculiarly abhorrent to him, and which evokes the cry for work or maintenance. He postulates the right to exist as inherent in existence. The command to be fruitful and multiply carries no responsibilities with it. The ideal world must

be had on easy terms, eliminating even deferred payment. Whatever the original intention of the Employment Bureaux may have been, whatever the aim of the administration of the Unemployment scheme, the scheme has been transformed into a vast instrument of socialistic policy and by its fruits it must be judged. It has failed to respond to the changing needs of a time of profound changes, and far from stabilizing employment it has *stabilized unemployment* by maintaining a reserve of men and women for service in occupations which have long passed the zenith of their usefulness.

3. BUREAUCRACY v. ENTERPRISE

Thus conditioned, private enterprise cannot but languish, working as it does under the most cramping restrictions and disabilities and supporting a large and useless retinue of dependents like some ancient squire of a decayed family living on his past traditions and shrinking from the withering blast of new ideas or the pressure of competition from outside. Even had the taxation of capital not been carried so far, such conditions would have endangered any industrial community and would have acted with cumulative force as the system diverged further and further from realities. To a State in such a situation, it would occur naturally that waning private enterprise must be supplemented in

some way by public action. This in fact has brought about two groups of measures. The first of these is the use of State credit to foster trade abroad when the banks and other financial institutions decline the risks. The second is the initiation of relief works. Unfortunately neither of these methods can pass the test of economic virtue. In pledging State credit on enterprise which the experts of finance consider unsound, we are in fact depreciating our credit. Post-war events on the Continent have clearly proved how hopelessly State credit can be brought down by unwise action until it becomes weaker than the credit of private individuals. By initiating works as a means of finding employment, the State is again pledging its credit and is doing so at a great disadvantage, for it is impossible for these works, by their very nature, to give a quick return ; otherwise they would already have been undertaken without State assistance. Such undertakings have, therefore, little more effect than if the money advanced by the public or drawn from the taxpayer were used by the contributor in the way he would ordinarily invest it or spend it. Certainly it is much less advantageous than if he had invested it on his own judgment in what would presumably give the early promise of a return and put the money once again into circulation.

There is still another disadvantage in this

procedure. Enterprise, as has been shown, languishes if the soil is unfavourable. If wages are out of touch with realities, the intervention of the Government, who are constrained by political influences to pay full rates, contributes to the support of an uneconomic level. This hinders the necessary readjustment that would bring values into relation with the level abroad, and prevents a revival of the export trade upon which we depend for supplies of food and material. That is the crucial test and the only possible conclusion is that the State by its very constitution can never effectively find a substitute for the judgment and initiative of its citizens working in an atmosphere of freedom.

The readjustment of the internal price-level to external changes is still more obstructed by proposals to pension able-bodied workmen and to delay the entry of youths into industry, proposals which merely reduce the productive capacity of the nation. It is suggested that we should benefit by a longer period of schooling for these youths. Are we convinced that the kind of knowledge to be imparted during the extended period is such as to increase their productive capacity which is the only test we can apply if we look upon their education as a fruitful investment? Educationalists are beginning to perceive that all is not well with our educational system, and that education both

here and elsewhere has gone too far in the direction of purely cerebral activities, thus leading to much unhappiness and discontent.

“A purely intellectual standard of life,” declares Sir Arnold Wilson, “entails misery, futility and ultimate decadence. Literary men, thinkers, professors, philosophers, preachers, teachers and politicians, have their place in life, but skilled manual workers are the real creators of civilization. If modern education had insisted more on hands than brains, civilized man would be more independent, and therefore happier, and less prone to believe that the individual has an indefeasible claim on his fellows in the person of the State, independently of any services he may have rendered or be rendering to it.”

The fact remains that the general effect of all such measures as we have discussed is to prevent the normal and natural accommodation of values that proceeds spontaneously in every nation without the slightest need of interference on the part of Government. Our own difficulties have been greatly multiplied by an immense extension of Governmental activities resulting in a wide range of wage, salary and pension contracts established without reference to the changed and changing purchasing power of our currency. Even before the crisis which led to the formation of a National Government

the Government and local authorities were handling approximately £1,000 millions of the national income. To that has now been added a further £80 millions. The national income before the war was estimated by competent statisticians to be in the neighbourhood of £2,000 millions in gold. Since then our population has increased by 10 per cent, and as gold has now recovered more than its pre-war purchasing power this would suggest a national income of not more than £2,200 millions. As against this it is argued that our average productive capacity per head has increased, even allowing for our greatly increased unemployment. Unfortunately for this argument, an increase of production does not mean an increased valuation in gold. If we double our production, as we have shown previously, we halve the price and receive the same quantity of gold. Anyone who wishes to satisfy himself on this point has only to observe the consequences of increased production in rubber, wheat, cotton or any other wholesale product. And mark the consequences. As values fall and the purchasing power of gold increases, the Government absorbs an ever increasing share of the nation's production ; the surplus available for foreign trade rapidly falls ; and the state of the nation's industry grows worse, for in valuing our production at well over £3,500 millions (which includes this

national burden) we are struggling to market our products at about 50 per cent above the world level. The world cannot concede our high price. It has no wish to uphold a higher standard of living here than is obtainable elsewhere. Capital reserves shrink and the burden of unemployment drags down one industry after another until even the strongest are unequal to the strain. At this moment we are disbursing in public expenditure well over one half of our whole pre-war income as a nation. That is clearly an impossible situation and the end has come with dramatic suddenness. In fact we have been living at the edge of a precipice, and we have already had our first lesson of the danger this involves.

It can be seen that the various forms which Government intervention has taken are no more than palliative in their effect. They resemble the action of a man who endeavours to cure a disease of his blood by external remedies. We may evade our difficulties in that way for a while ; we may mortgage our future as we are doing now ; but we are still left with the task before us of creating conditions which will favour the rapid adaptation of the community to changing circumstances ; and for that we must rely on the ability of each individual employer and employee to work out his own salvation in his own way with a full and

intimate knowledge of his own special circumstances. We have only to contrast a small force of daring men inspired by a single purpose, each infused with his own personal courage, with that of an inert mass moving in conformity with set rules and regulations imposed upon them by a superlative "brass hat." The one is a live unit marching to victory, the other moves with feet of lead.

It is the tale of Gideon again.

The problem before us in this Britain of ours is that of creating an immense increase of productivity and of setting it into free circulation. We suffer because we are unproductive, but when we have achieved the increase of productivity that is necessary for our welfare, we are still left with the responsibility of providing for the means of exchange for that increase.

If we divide humanity into two broad divisions, those who can find profitable employment for themselves and their fellows, and those who depend on their fellows to find employment for them, it becomes obvious that we have tangled the feet and bound the hands of the former by inordinate burdens and excessive regulations. There can be only one solution : to liberate them as far as possible from these entanglements. We are dangerously depleting the numbers of this most valuable section of the community, if only judged by the serious

decline in the birthrate of the prudent and responsible, while the irresponsible who are fostered under this system are free to multiply, conscious that the State has taken over all their responsibilities without asking the surrender of any of their privileges. That is the inevitable road to disaster, perhaps not long delayed. Be assured that there is no substitute for the man of enterprise ; least of all can it be found in the Government official, however wise. By the very nature of his occupation, the latter is precluded from taking risks either for himself or for his employer, the State. As far as possible, he is sheltered from the blast and is unaware of the burden of the risk-bearer for whom he has as a rule little sympathy or understanding.

Nor can we look to any system of education, however intensified, applied to the lower strata in the social order to supply the deficiency. To quote from Sir J. Arthur Thomson :

“ If there are two very gifted members of a poor stock who are personally equivalent, so to speak, to two members of a good stock, the children of the former will tend to regress ; those of the latter will not. The moral is that care of good stock is more important racially than care of very exceptional members of poor stock.”

Quality, in other words, is inborn, not impressed ; and race stands for quality. We may,

as in Russia, destroy one class in order to raise another, but the need remains of creating a substitute, with all the weight of biological evidence against the probability of that substitute being anything like as good as what we have destroyed. The question of unemployment is thus bound up with the need for breeding leadership and independence, qualities that by their strength or deficiency make or break a nation. We are rich in those qualities or have been, but we are perhaps unconsciously stifling them. We fail to prize them at their full worth, and if once we lose the stock from which they spring, the very character of the race itself will have changed.

CHAPTER XVI

LABOUR AND INDUSTRY

I. SENTIMENT AND REALITY

IT may be well now to summarize the situation as it stands to-day, and to review the more salient mistakes which have reduced Britain to her present plight.

Life is work and work is life. We work to create or procure the food by which we live. Without work the community must perish. Here are truisms which have apparently been ignored. Yet the first and most insistent purpose of all sound government is surely to organize the State so that every member can pull his full weight and contribute his quota to the national well-being. In the industrial era we unfortunately shifted the centre of gravity of our whole economic system, favouring industries which must export to feed those engaged in manufacture, and relying upon our skill in marketing to effect the exchange. As long as wages could be adjusted to the give and take of the law of supply and demand we were able to meet all competitors. We could profitably

market our surplus abroad and permit the population to increase far beyond the point where it could be fed with home-grown supplies, but we were placing ourselves in dangerous dependence on the outside world. We were creating what was at best a state of unstable equilibrium and the events which have followed the Great War have daily brought this more openly into the light. The removal from the employer of the control of wages through various legislative acts which followed the war struck a blow at our manufacturers and placed them at the mercy of their foreign rivals, who maintained their liberty to adjust wages according to the capacity of industry to pay, and were able to evade agreements on the question of hours. If wages do not come out of profits they must necessarily come out of capital, a process which sooner or later results in mills and factories closing down and throwing men and women out of employment. Having weaned the people from the land and over-developed industry, we were now dependent upon the rest of the world for a market for our produce, and the liberty to fix our standards of living was in these circumstances no longer ours. Industry was pledged either to adopt the conditions prevailing in other countries or to destroy that section of industry which derives its existence from exports. To that there was no alternative.

Even if sentimental considerations awakened a laudable desire to improve the living conditions of the people, we were by our own choice no longer privileged to oppose an unalterable law : wages must be earned ; and from the moment that we adjusted them without respect to the returns which capital requires, we were eating the seeds of death.

The country is thus to-day presented with the choice of a shrinkage of national industry and a permanent reduction of our population (and possibly the shrinking birthrate is evidence that we are arriving at this stage) or a reconstruction on new lines with a wage basis corresponding to that of competitive countries. Should we decide to enlarge the market for our surplus production by recapturing the home demand, we must renounce our ancient prejudices. We have not the means to maintain in idleness an army of men and women who should be engaged in the growth and preparation of food, clothes and all that pertains to our present mode of life, and to supply them with the unearned means to buy vast quantities of food and manufactures from abroad. But that is not our greatest loss. We are sapping the character of our people, an asset we can never replace. Our soil is fertile, our climate fickle but productive, for it is free from extremes of heat and cold ; our men and women are skilled workers and keen

on earning a living. Yet misgovernment has deprived the subject of that boon to which every human being aspires and which justifies his existence—the opportunity to earn a living and to produce and reproduce on that basis. We have defied the most fundamental law of life.

We have shown how the clog in the industrial machine originates with the currency system. The liberty we assumed between 1914 and 1925 to maintain an independent self-regulated system of currency may have been abused, but we departed from that only to plunge into a system which tied us hand and foot to the United States and other holders of gold, a bondage which was made still more oppressive by the very heavy liabilities we had incurred towards our transatlantic ally. In endeavouring to maintain a higher standard of living by paying increased wages and reducing the hours of work, and in some cases decreasing the task performed ; in pledging ourselves at the same time to keep our markets in unison with those of other countries whose pace varied from our own, we sought, as it were, to make water run uphill. The current unfortunately ran the other way, or, as in the tale of the man and his horse, it was the horse that blew first.

There has scarcely been a moment since the inception of the gold standard when the Bank of England has not felt the acute strain of

preventing our gold from draining away to America or France, forcing us to indulge in every kind of device to prevent the flow. We raised discount rates which merely put a brake on commerce at a time when commerce needed stimulation ; yet we hoped that this would protect us from the full effect of the natural operation of the gold standard.

The country has thus lived from hour to hour in a state of doubt and uncertainty, knowing that at any moment the Bank of England might be forced to check any budding expansion of trade by a sharp alteration of the Bank rate. A distant disturbance in the international money market or some unfounded rumour, under these conditions, was sufficient to affect the whole fabric of the productive machine. So sensitive is our money market that it resembles those delicate instruments that record earthquake shocks at the other side of the world. It has made industry nervous, vacillating, uncertain of its future, and therefore unable to look ahead or to elaborate plans beyond the immediate needs of the moment. We have created a dangerously unstable regulator and bound it fast to the delicate mechanism of industry, thus displacing its government from the hands of those engaged in it, and placing their destiny at the mercy of forces beyond their control.

We have drifted from a position of safety into

one so precarious that capital is shy of participating in industry. Hence the vast increase in the volume of bank deposits. The preference for bonds or securities that are guaranteed a fixed return can do nothing for the development of industry which no longer possesses the attraction for capital that it enjoyed last century.

The Bankers reluctantly find themselves in control not only of currency but of industry as well, and when bankers rule business, enterprise languishes, as it is not the business of bankers to take risks. The consequences are unfortunate for all concerned. With nothing left to remunerate capital, and with falling prices rendered unstable through the faults of our monetary system, manufacturers gradually sink deeper into debt and the road to recovery recedes into the distance.

2. THE SACRIFICE OF INDUSTRY

Were we deliberately to set ourselves the purpose of destroying industry we could find no better way than this :—To withdraw the power of fixing wages entirely from the hands of the employer ; to remove his right to determine hours or conditions of labour or methods and allotments of work and to place these with outside bodies responsible only to themselves ; to permit Government to fix taxes without regard to the capacity of industry to pay ; to allow the

Inland Revenue to dictate the form in which all balance sheets are to be made and to discourage the creation of reserves or the provision of adequate depreciation.

These things to all intents and purposes are what the nation has been doing. We have created at least four entities, none of which has any financial interest in enterprise, empowering them to impose their own terms. The days appear to have long passed when the master formerly in command of industry could captain his own ship and was responsible for the life and safety of crew and vessel. Throughout all this, there is the false assumption that the State can do what we are unable to do for ourselves, but it is a dangerous slope on which we stand. The State already meets pre-maternity, and maternity charges, school bills, doctors' and dentists' fees ; it subsidizes houses and feeds and clothes all who are out of employment, it supervises us from birth to death until it may be said of some citizens that the State will pay all their expenses from the day they are born till the day they are buried. Only the vast accumulated wealth of our predecessors, who were free to organize their lives on their own lines, permits the continuance of this wasting process. And it looks ominously like plunging back into the status of a second-rate nation with a "poor white" degenerate and under-nourished popu-

lation. Sad it is that an unnatural and unequal conflict has been created and kept alive by the opposing interests of capital and labour, although all the time there is the vital necessity for friendly co-operation. Yet we have sufficient experience now to see for ourselves the way of safety. The first reforms that call for consideration are :

1. A monetary system which will stand the test of modern conditions.
2. The regulation of imports and the stimulation of exports.
3. The gradual elimination of payment for idleness.
4. A reconstitution of the whole wage-fixing machinery.
5. A revision of taxation which will eradicate the taxation of capital.
6. The restoration to the subject of some, at least, of the liberty formerly his to manage his own affairs, and a rigorous curtailment of the activities of the bureaucracy.

On these terms we may create wealth and enjoy it in ever-increasing abundance. On any other terms the process of decay which is so painfully manifest from end to end of the country will sap the very fibre of our being and leave us one day no longer a power but merely a geographical expression.

CHAPTER XVII

ECONOMY

I. THE CALL TO ECONOMY

THE nation has been called upon by its leaders for great sacrifices and high courage for the sake of restoring British credit, and if such an appeal is to succeed all ranks and classes must share in the common effort to increase production and reduce expenditure.

“But surely,” the critics will say, “we are already suffering from over-production and under-consumption. You will make trade worse than ever and increase unemployment.” Yes! but only if you fail to supply the means of exchange that will enable you to market throughout the world the surplus you will thus have in hand. The world is only too anxious to exchange its products with you, if you will facilitate the process, and that depends on its being a fair exchange. Everything we do must be related to that end. If education makes us more efficient craftsmen, if social services increase our output, the expenditure is justified. If not, it must be brought within the measure of utility.

The condition of our success in marketing thus depends on our offering "*value*" and on nothing else. The marketable value of the pound sterling is now governed not by gold but by our balance of trade, a far more healthy condition for us. How artificial was the position before the break with gold can be shown by the following figures :

Year.	VOLUME.		VALUE.		
	All Imports.	British Exports.	All Imports.	British Exports.	Wholesale Price-Level.
1913 ..	100	100	100	100	100
1924 ..	107.3	76.1	155.0	190.0	166.2
1929 ..	121.0	82.4	133.6	159.0	136.3
1930 ..	118.2	67.5	117.3	151.8	119.5
1931 {	107.0	52.6	98.9	141.2	106.3
1st half {	110.3	50.1	97.9	137.4	104.3

It can be seen that while our imports are 10 per cent greater than before the war our exports have shrunk to about 50 per cent of their pre-war volume, and the secret of the shrinkage lies in the high price ; we are still about 40 per cent above the pre-war price which corresponds fairly closely to the cost of living and wage indexes, while our customers who sell to us are obtaining 2 per cent less than the pre-war price. Exchange on these terms is obviously impossible and, in fact, even when we recoup the higher prices we charge, there is a deficiency of 40 per cent to meet. We are often told that the invisible services will make up the balance, but it is only fair to assume that they are as much

affected by the high internal wage- and price-level as any other form of service that comes to light in the visible exports, even if we had no other means of verifying their decline.

2. A DUTY FOR ALL

It may be argued, however, "If economy there must be, let it begin and end with the wealthy." To take up such an attitude is to assume that there is no personal duty of citizenship except for the few, a view which would lead to the logical conclusion that those who made the sacrifices would demand the control of the machine, and the franchise of the irresponsible, having no material sanction to support it, would cease to have any value and would pass, as all anomalies and injustices do pass, with its own decay.

Such a suggestion, too, can only be made without regard to the constitution of society. The fabric of civilization is woven out of strands of every shape and colour due to the diversity of interests that each of us have in production, whether as workers, savers, organizers or experts. Out of that is born the amazing complexity of services that are a feature of modern society. In contrasting the growth of civilization in nations unlike each other in origin, language or temperament, and remote from each other historically and geographically, one is struck by

the growing variety of pursuits and avocations as nations rise towards a higher plane. The higher the civilization the greater the diversity of wealth and of interest, so that in Britain, France and Germany, each developing in its own individual way, we can test the height of their attainment by their power to evolve the finer and rarer products such as the music of Germany, the literature of France, the poetry of England. In like manner, when we compare the capital cities of different nations we find without any conscious imitation on their part the same general features ; parks and recreation grounds, churches and palaces, luxury stores and sixpenny bazaars, street markets and stock exchanges, studios and concert halls. Now all these things arise purely through the extraordinary diversity of human powers and preferences that enjoy free scope in accordance with the varied tastes and pockets of people of every station and degree. The liberty to choose one's own occupation, to strive for the full attainment of one's ambition, limited or unlimited as the case may be, probably makes for more human happiness than any other system that has ever been devised whether by the wit of man or by the evolution of the ages, even although it covers all the ground from hardship to luxury. Restraint of liberty, which is the alternative, has always been in the nature of punishment.

It would be hard to account for the amazing progress of human society on any other explanation than its power to secure an infinitely greater diversity of products and to make use of an infinitely greater variety of services than any social order evolved in what we call “the lower creation”; and that is only rendered possible by the complete freedom that enables each element to express in his own way his wants and his powers.

The society thus evolved, despite all its wide differences, has a certain static quality inevitable to its manner of growth. Men and women acting for mutual service adopt careers and perfect themselves slowly by long training and experience. A great emergency like war puts everything to the test, yet leaves the fabric substantially the same. Artists, poets, sailors or mechanics find new means to bring their talents to useful purpose if they are not wasted in other ways, and civilization seems to go on much as before, with schools and colleges, railways and theatres, art galleries and newspapers running as a normal expression of the people's activities, however attenuated by the circumstances; for to destroy any of these completely would be like dislocating the bones or altering the features of the face. Now economies do as a rule affect most powerfully the luxury trades. That is inevitable. But if economies were carried to

the point of paralysing such activities completely, ruin would befall many worthy citizens unable to begin life afresh in new occupations, and the destruction wrought would be capital destruction, a loss to the State itself equivalent to the loss of an important section of its population with all its repercussions on the rest of the community.

If we are to contemplate society aright we must grasp that the whole distribution of the necessities by which we live is governed by the provision of services in response to the multifarious needs and desires of our fellow citizens from the simplest to the most complex. We cannot condemn the writer who produces a philosophical treatise that appeals only to a narrow group of fellow workers. It has a value to the community as a whole, and it is by this and other services that the ultimate distribution is affected which maintains the corporate existence of the nation. If the reward is not always by merit we are at least assured that service is the key to reward, a condition which we are apt to ignore at our peril. Each one is part of the fabric, and who can judge whether this thread or that can be drawn out with safety to the rest? We have this satisfaction, that in the final issue, however wealthy a man may be, he cannot enjoy his wealth without sharing it with his fellows by fruitful investment, and if economy is to be just it must be general.

It must proceed like the pruning of an orchard, preserving, not destroying.

Dr. Johnson once affirmed that economy must be a habit of mind. Until the spirit pervades all classes it cannot achieve its purpose. But what is that purpose? General abstinence in itself does not benefit trade even if good for the individual. It will create savings, it will reduce imports, those things are good ; but if abstinence does not express itself in the form of a lower cost of production of the goods we sell, it will be worse than useless ; it will then merely reappear in the unemployment returns. The problem of the nation is to re-create the export trade. That means that we must offer better value if we wish to have gold in exchange for our services. The abstinence we practise must create the surplus that we shall offer to our customers abroad in payment of the supplies we need from them. Economy must figure in the price-level, and the wage-level must bow to that price-level if we are to revive the free exchanges between ourselves and the world that once brought us our wealth. The wheels of commerce have been arrested because the basis of a fair exchange is wanting.

Democracy to-day is on trial, but democracy will win if we practise in our homes one and all the virtues that enrich a nation and that our fathers so signally displayed.

CHAPTER XVIII

SOME CONCLUSIONS

HOW confident we were, we British people, when we emerged from the Great War ! We, who had helped to save Europe, could be lavishly generous to friend and foe. We would pay our debts and forgive our debtors. How noble it all sounded in the flush of victory with our men flocking back to their old duties in a spirit of peace, prosperity and glory. And the reality ? The suspension of payments in gold !

Is this the fruit of victory ? Surely never nation has more foolishly and wilfully within the short span of thirteen years turned triumph into failure, achievement into misfortune and found her pride so quickly humbled. For pride it was that made us so terribly over-estimate our strength that we light-heartedly assumed a debt in gold of half the value of the United Kingdom, and then doubled the pledge on our resources by piling up extravagant social services. It was the rake's progress ! History is unforgiving and deals in realities. Every nation sooner or later is called to the bar that judges its fate by its

willingness to conform with the basic laws of existence. One after another Empires have risen and ridden to their doom. *Have we* the courage to face realities?

Like Rome we are breeding an inferior race and allowing our best to perish, while encouraging the growth of a parasitical class ; and Rome fell. We have allotted to the industries of Britain a task which is hopelessly beyond their power and resources, and they are visibly crumbling beneath the weight. The vivifying stream of capital by which we nourished our Empire and supplied new food for the nation, has ceased to flow and already we have to deal with discontented subject peoples and ominous signs of waning allegiance.

Our people no longer emigrate to fill the waste spaces and make them fertile and habitable, for where capital fails to flow, progress is arrested, and they are no longer welcomed even among their own friends.

No narrow traditional policy will avail us here. The logic of tradition too often contains the seeds of decay. The very fatalism that built the Mohammedan power in war enervated it in peace. We have seen Britain rise to leadership among the nations from a small nation less in numbers than the present population of London. Living mainly in isolated communities, she bred a type strongly individual in outlook

and self-reliant in character. The rapid development of the railway unified this people and gave it a new corporate sense which found expression in great national movements, such as free education, trade unionism and a hundred other forms. But the old family tradition was losing its force. More and more reliance was reposed in Parliament. Liberties were surrendered to achieve the assurance of comfort. The State increasingly assumed the responsibility of the head of the family, while the suffrage became the instrument by which his will was expressed. As the suffrage widens to include all classes and all ages, the sense of responsibility diminishes till the main motive behind it comes to be favours to be won, and the unabashed appeal of the candidate is directed to the personal interest of the voter.

Against these tendencies a small minority fights a losing battle. The power now has passed from their hands. Completely outvoted, they struggle for the old independence in the rearing and education of their children and the conduct of their business. Their very independence is their undoing. They sternly resist the modern tendencies towards the fusion of business interests, preferring to maintain their individuality. They would rather fail with their business than sacrifice what is elemental in their own character. These, alas, are the very types that formerly led the nation, inspired its ideals, adventured

greatly and scattered its sons, East and West, North and South, to assert their qualities of independence. The centre of gravity not merely of the political system but of the industrial structure changes and has changed, perhaps far beyond the possibility of restoration. The flowing tide of Socialism is bearing the nation on a new course, but in seeking to promote the welfare of the people, we have undermined the very foundations of welfare, the productive capacity of the nation. No easy compromises, no tempting postponements, but only the far-seeing and resolute actions of men of courage and determination will avail in such circumstances.

At the outset let us realize that the gold standard has betrayed us : and it will continue to betray us, for by its very nature it puts our trade and commerce in the power of any nation or body of peoples who can secure the supply of gold and withhold it from use. There is nothing more certain than that the man who to-day hoards gold is in a far superior position to any other investor. If gold doubles its purchasing power as it has done within a few years, it results in a re-valuation by which all stocks or commodities are halved in value except those that are fixed in terms of gold. Thus every patriotic citizen who loyally invests his savings to promote industry or commerce finds half his capital gone, or worse, if, as so often happens,

debentures or gold bonds rank before he receives his share. The wealth of the country is transferred to the holders of gold or its equivalent, while the genuine investor is crushed out of existence. Indeed, the temptation to hold gold even without any return in interest becomes overpowering, and this is manifested by the great sums of money now held on deposit with the banks by frightened investors, and the wide divergence between short-term money and long-term loans. This divergence in itself creates everywhere a sense of monetary insecurity, as money obtained in this form may be withdrawn at any moment, and the crisis in Germany is attributed largely to this cause. We ourselves, depending largely on short-term credit, are therefore particularly vulnerable. These conditions must end, but they cannot end until we have put our whole currency beyond all such influences by relating it directly to the commodities which form the bulk of our commerce as a trading nation.

The reform of our system of taxation is no less urgent. The leaning to a socialist equalization of wealth has been our undoing. However much inequality of fortune may be abhorrent to us, this inequality is a product of liberty and is an essential ingredient in the progress of civilization. Have we not witnessed again and again that the luxury of one age becomes the

commonplace of the next? Modern ideas compel us to hold that the level of life should not sink below a given standard of welfare, and we must accept the consequences in regulating the lives and in some degree the liberties of those who are unequal to the task of maintaining the standard required. But great accumulations of wealth are beneficial, if only because the men who accumulate it are incapable of consuming more than the personal needs of themselves and their dependents. Such wealth therefore becomes a reservoir of productive employment for the benefit of all. Men prove their capacity for leadership in the field of finance and industry by the very power which brought them to the forefront. To those who look to a species of common ownership as the solution of our troubles, a warning is due. Russia is in the throes of a great experiment, the results of which none can foresee; but so far as it has gone, it has been shown to involve a surrender of liberty to find a parallel to which we must turn back to the Incas of Peru or to the ancient civilizations of Greece and Rome. Are we prepared to abandon our own hard-won freedom, which gives free play to the genius of the individual working in an environment and under conditions in the main determined by his own choice?

We should be proud of our power to evolve great capitalists just as we are proud of our power

to evolve great explorers and great scientists. The punitive taxation of wealth brings its own revenges. It is a nation's expenditure, not its savings nor its capital, that should be regulated in the interests of the State.

Since the State is virtually a partner in every business and industry in the country, its interest as a good partner makes it imperative that it shall use its powers as the French do, not merely for the welfare of the workers, which is, after all, only a section of the problem, but to promote the prosperity of the industry on which they depend for their existence and to create secure conditions for its working.

Adam Smith wisely said,

“A country that has wherewithal to buy gold and silver will never be in want of these metals. They are to be bought for a certain price like all other commodities, and as they are the price of all other commodities so all other commodities are the price of those metals.”

Thus the nation that wishes to attract gold can only do so through the products it markets, and the converse holds equally true. On these terms every pound that we pay for unemployment is equivalent to an export of gold, for it produces nothing in exchange. This is true even if we had not to send abroad for the food and materials necessary to feed our hordes of idle people. The pressure on our gold reserve is

now known and understood. Borrowing will only defer the evil day and intensify the strain.

The trade unions which play such a preponderant part in politics to-day have failed to grasp this fundamental fact in the problem with which they deal. In fixing minimum wages and regulating the competition for employment they ignore the responsibility that their action creates for those who fail to find employment ; and the very principle of regulated competition which they uphold for the benefit of the trade unionist is denied for the products he creates by his labour. No unemployment scheme will ever be sound that does not fasten on those responsible for the sale of labour, the responsibility for the excess supply. If the interests of labour are to be served, it can only be attained by more far-reaching methods. The Labour Bureau has been perverted into something little better than a glorified Relief Institution.

The keynote of democratic government must always remain that of *responsibility*, and our failure to understand this has led us far astray. Mr. Bernard Shaw, in reviewing the Soviet system, perceives this fact :

“ Russia’s solution of the democratic problem,” he writes, “ excludes from official authority and from the franchise, the ignorant, the incompetent, the indifferent, the corrupt and the pugnacious and politically incapable masses

who, though they revel in a party fight or any other sort of fight, can make no intelligent use of their votes, and are the dupes of every interest that can afford the cost of gulling them. Responsibility to such innocents is no responsibility at all. . . .”

Responsibility in Russia, he declares, is real responsibility. These are hard words from a hard-grained Fabian.

To be free agents within the framework of an organized State and to surrender only those liberties that make for the common advantage, would seem to most people the ideal relation between individual and State. We in Britain have proceeded far beyond that region of common advantage by loosening much of that personal element of control on which we threw so amazingly in the reign of Queen Victoria. Herbert Spencer, with his keen intuition, divined the tendencies that in his time were only just beginning to come to light, and forecast with uncanny vision the developments that would follow.

In *Man versus the State*, a book which should be read and re-read in the light of present events, he writes :

“ Dictatorial measures, rapidly multiplied, have tended continually to narrow the liberties of individuals ; and have done this in a double way. Regulations have been made in yearly-growing numbers, restraining the citizen in

directions where his actions were previously unchecked, and compelling actions which previously he might perform or not as he liked ; and at the same time heavier public burdens, chiefly local, have further restricted his freedom by lessening the portion of his earnings which he can spend as he pleases and augmenting the portion taken from him to be spent as public agents please. The causes of these foretold effects, then in operation (1860) continue in operation, and are, indeed, likely to be strengthened.”

Again :

“ The more numerous public instrumentalities become the more is there generated in citizens the notion that *everything is to be done for them and nothing by them.*” . . . “ Every extension of the regulative policy involves an addition to the regulative agents, a further growth of officialism and an increasing power of the organization formed of officials.”

“ Every candidate for Parliament is prompted to propose or support some new piece of *ad captandum* legislation. Nay, even the chiefs of parties—those anxious to obtain office and those to wrest it from them—severally *aim to get adherents by outbidding one another.* Each seeks popularity by promising more than his opponent.” . . . “ Journalists always chary of saying anything which is distasteful to their readers are some of them going with the stream and adding to its force.” . . . “ Increasing power of a growing

administrative organization is accompanied by decaying power of the rest of society to resist its further growth and control."

And he warns us of the danger of "a grinding tyranny like that of ancient Peru under which the mass of the people controlled by grades of officials and leading lives that were inspected out-of-doors and in-doors, laboured for the support of an organization which regulated them, and were left with but a bare subsistence for themselves."

This was written nearly fifty years ago. What a prophetic—and pathetic—picture of our England of to-day !

Have we the strength to face the issue ? The choice is fraught with big potentialities for the future of the race, the Empire, and even the World, which has paid such tribute to Anglo-Saxon ideals. But we need harbour no illusions. In Kipling's words, "No easy hopes or lies will bring us to our goal."

England triumphed in a great cause during the war. With victory came reaction and the desire for an alleviation of the struggle. We believed that life could be made much easier. We believed we had paid the price for it. The years that have followed have merely lost us ground. The struggle is eternal. Each and all of us has his part and cannot be excused from it.

EPILOGUE

EVENTS have moved rapidly even as these lines are being written and the decision of Britain to suspend the gold standard has been forced upon her instead of taking the form of a calm and reasoned judgment on premises such as we have here set out. But the decision nevertheless is irrevocable. The gold standard has gone beyond recall, because never again will it be safe for a nation, whose existence as the central money market of the world depends on a just measurement of values and of all contractual liabilities, to return to a standard which has reduced her to impotence, betrayed the world, endangered her dominions and dependencies and brought suffering and disaster on a scale only comparable with a great war.

Were gold as a standard the last word in science there might still be some excuse for hankering after our old love ; but its complete failure has discredited it for ever. England, betrayed once, cannot be betrayed again if she is to survive as a great power for good in the world. To this false god the nation has made

sacrifices which no other nation would have endured. We have allowed the Juggernaut to ride over the body of industry and mutilate it beyond recognition.

The path now is clearly marked out for us. The devaluation of the pound sterling will effect as quietly and smoothly as the Daylight Saving Bill the readjustment of values to the necessities of the case, but that devaluation will not have fulfilled its work till it has set the wheels of industry whirring as busily as in pre-war times ; till the people of these islands are once again freed from the bondage of idleness which holds them like the frozen waters of a wintry stream. The piecemeal effort to adjust wages, salaries, incomes and doles to an insatiable gold standard by a kind of surgical operation has proved to be cruel and unfair, for, like Shylock's pound of flesh, it cannot be secured without copious shedding of blood. The remedy of higher taxation is only likely to drive our evils still deeper by curtailing the consumption of the public at the very time when the world is suffering from under-consumption, by draining our savings and by still further overloading our already harassed industries.

Will Britain be poorer with a pound sterling that has lost its old anchorage with gold ? Surely not ! We are setting out on a new

voyage. No longer bound in a sea of Sargasso where our decks and gear are rotting, we shall be sailing with chart and compass, for we shall, and must, regulate the pound sterling to conform with the values in which we trade and which will give us the highest degree of convertibility that has yet been known to man ; the convertibility of the great world's markets that are centred in the world's economic capital.

A nation working is infinitely richer than a nation idle, infinitely richer and infinitely happier. To find men in England, as one does to-day, willing to declare that they were happier not merely in wartime but in the field of war than they are to-day, is surely the most crushing testimony to the sufferings we have endured and the greatest menace to the cause of peace.

Our break with the gold standard will not have done its work till we are all busy once more—and not merely we British people—till the whole world under our leadership is busy ; till there is a guarantee of a fair exchange between all nations for all time in all their transactions, including their debts and other obligations.

And nothing will better serve the cause of Free Trade. Protection under present conditions becomes merely a feeble gesture of defiance against the gold standard. It is an effort to render oneself independent of it by

making the internal price-level irresponsive to gold ; but it equally makes it necessary to dump one's surplus in the world's markets in order to secure the gold required for internal purposes, and when the whole world indulges in that practice chaos results, a state of things from which Britain is bound to suffer more than any other nation.

This national crisis may prove to be England's salvation if she acts with courage, imagination and a firm sense of realities. It has come none too soon. Our adherence to gold was rapidly destroying our power, political, financial and industrial. Like the phœnix, we can arise now with new life and new heart to new tasks. Our power to lend will revive with our power to produce and to sell our production. New power to dominate the councils of Europe will come with industrial strength and with our ability to do justice in all our dealings through their relation to a sound standard. France made even greater sacrifices than we are called upon to make, and won. We, with hearts and minds strengthened by our tribulations, can do no less.

We have taken a step now fraught with importance to the whole world, and already the confidence that the world has in our integrity and honesty is bearing fruit. Africa, India, Ireland, Egypt, and the dependencies remain attached to our system. Denmark, Norway,

Sweden and Finland have followed suit. We make it easier for Australia and New Zealand to return to the fold. The adherents of gold are even now in a minority. Other nations, even the United States, will find that allegiance to gold means far greater uncertainty than allegiance to the pound. But that imposes upon us one imperative duty : to make the pound sterling the *Symbol of Stability*, a safe anchorage in all storms, bringing freedom from political or financial domination. “The King is dead ! Long live the King !” No longer Tyrant gold but a new “sovereign” who shall be faithful and just to all men.

Reader, do you doubt that this is by far the most vital question of the day to you and to all men, far exceeding in importance the question of Free Trade or Protection, or any other question discussed in this volume, all of which must finally come to trial at this bar ?

Whether you be workman or industrialist, merchant or clerk, farmer or landlord, bondholder or shareholder, the question is for you to master and to decide, because upon the decision may hang the future of your children and generations still unborn.

Nothing worth while was ever achieved on this earth without strong convictions and deep enthusiasm. Are you, a witness in this great impeachment, willing to stand silent ?

APPENDIX I

COPY OF AN ARTICLE ON "THE WAR AND ITS EFFECT ON OUR CURRENCY," ISSUED JANUARY, 1918

1. IN view of the daily accumulating issues of War Loans, it is both natural and right that our Bankers and Merchants should at this stage earnestly devote their minds to the highly important question as to how the nations now at war will stand financially at the conclusion of hostilities, and how the interest on the debts incurred will be met. It is clear that the collection and redistribution of the vast sums that will become payable in interest on such huge borrowings will effect a radical change in society. We cannot have a great increase in the spending power of the non-productive holders of securities without an equivalent increase in production. But it is hardly conceivable that after the war the producer will be satisfied with a smaller reward for his efforts, whether he be artisan, farmer, merchant, or manufacturer, especially as the cost of production of every article will have

increased, while the amount produced will have diminished, through the loss or mutilation of skilled men. But again, if money is badly wanted for the restoration of enterprise, the return in interest on the investment of money cannot be reduced. If enterprise and initiative are urgently needed to restore the community to normal conditions, they must surely be better rewarded than in peace-time, not worse. Yet it is obviously impossible for everyone to have a larger share of the products of industry. Somebody or something must give way.

2. The problem needs deeper examination. If we are to make a true Balance Sheet of the nation the assets of the individual holders of goods and property must be massed with the assets under State ownership. Equally the indebtedness of the nation must be massed with the indebtedness of the individual. If the balance thus arrived at is true, the value of the goods and property held by the nation and its people, constituting its assets, should coincide with the proprietary claims of the nation and its people, constituting its liabilities. But when we come to look into the matter further we find that, since the war started, instead of an increase in the assets, there has been a serious shrinkage through the waste of war, the depletion of stocks and the difficulties of importation, the interruption to the repair and the

renewal of houses, railways, ships, etc., and our failure to make good the decay of property generally, except such as is urgently needed for war purposes, much of which may be scrapped on the declaration of peace. To take a single instance, the insufficiency of labour available for the weeding, manuring, and preparation of the land has caused great deterioration, which is showing itself in smaller crops. This has been brought to light in France, where steps are being taken to arrest this tendency.

3. What, then, have we to set against these greatly reduced assets? Apparently an enormous increase in the liabilities. If, for illustration, we put our present assets (allowing for the great depreciation that has taken place during more than three years of war) at the equivalent of sixteen thousand million pounds, or say a reduction of 20 per cent from an estimated figure of twenty thousand million pounds before the war, we find, *per contra*, that our liabilities, i.e. the proprietary claims on the British estate, have increased from twenty thousand million pounds to twenty-five thousand million pounds or thereabout. These liabilities consist of bonds, mortgages, stocks and share certificates, and other forms of legal security, all representing so many pounds sterling, to which must be added the various issues of Government loans, war bonds, exchequer bonds, exchequer bills, etc.

Clearly there is one way only possible to equate these two, debit and credit, and that is by altering the measurement of value, and breaking the nexus between the pound sterling and its gold equivalent. But, indeed, the nexus has already been broken, and the Continental exchanges begin to expose that fact. When trade once again resumes its normal course, the real value of our tokens of currency will be revealed.

4. We have always been used to thinking of the connection between the pound sterling and the gold sovereign as inviolable, but we must clear our minds of any such delusion and face the facts courageously ; and we shall not be alone in having to do this. The other belligerents and possibly some of the more harassed neutrals will find themselves in exactly the same plight ; our enemies in a far worse one, for their resources are exhausting themselves more rapidly than ours.

5. In discussing this problem we have to remember that we have really no valid precedent for the existing conditions. Never before in the history of the world have debts been incurred on such a scale as now. No conflict has ever been fought with more determination, and the issues at stake have never been vaster. It is certain, therefore, that no financial consideration will deter either side from fighting this war out to a finish, so long as the belligerents

have the man-power and the energy to devote to war. No capitalist or body of capitalists, however powerful, could, even if they attempted it, succeed in depriving a determined people of victory because of the possible financial losses that would be involved. Again, it must be remembered that a large proportion of the money spent on this war has been spent on the basis of a sovereign with little more than half its normal buying power. Is it likely, even if it were feasible, that any Government would attempt to redeem these debts on a scale nearly double that on which they were contracted, by re-establishing the spending power of the sovereign that prevailed before the present war? The truth is that we cannot reconcile the pound sterling and the gold sovereign. Every commodity in Great Britain has had to be valued higher, in order to equate our present liabilities, and the same is true of gold, although it is not yet apparent. The cost of producing gold at any moment must depend mainly on the cost of commodities in general ; and the gradual closing of the less remunerative mines will lead to a falling-off in production and increased purchasing power for gold. It is true that, if gold ceases to be in demand for purposes of circulation, to guarantee the exchanges or to maintain the hoards of the European powers, the market may be satisfied with a smaller

supply. But the cost of mining must eventually dictate the equivalent in produce that an ounce of gold will buy.

6. A proof of the stability of the present increase in general values, and of the fact that the credit balances of the community are for the moment greater than the assets, may be found in the rise that we are witnessing in the price of many commodities which are in no way essential to war, such as curios and other objects of art. This rise is taking place, although for the time being there is practically no competition for such articles from rich Americans or Colonials. No one would be so ill-advised as to buy these articles in the expectation of losing money in their resale after the war ; and doubtless, the purchasers realize that the market is at present comparatively free for those who have a surplus to dispose of, and that after the war, when trade resumes its normal flow, the opportunities of sale will be greater than ever.

7. It is clear, then, that by a fairly elementary method, viz. the balancing of the nation's books, we can arrive at the real depreciation of the currency, but of course, in making up a Balance Sheet, we must take into consideration a good deal of loss on stock exchange valuations, though in many cases these losses are only temporary. Nor must we lose sight of the great diminution in our holdings on Foreign and Colonial invest-

ments, the sale of which has, in many cases, been effected in conformity with the requirements of the Government: but the money so realized has undoubtedly been re-invested so that the nominal amount of wealth remains as before. Making this and other allowances, our Balance Sheet will still result in a *reductio ad absurdum*, unless we greatly reduce the spending power of money to all and sundry, rich or poor, worker or *rentier*. But with a population reduced or partly incapacitated by war, the competition among workers for employment and among producers for a market will certainly be less strenuous than formerly, and this should ensure an adequate share of the nation's produce to all who take part in its creation or distribution. It follows that, through the same causes, a smaller proportion of the nation's produce will be available for that section of the population which contributes nothing actively to the nation's output, and which depends solely on the interest of its investments (so-called unearned income), especially as the class of non-producers will be greatly swollen by the thousands who have been bruised or broken in the war, or whose strength or efficiency has in one way or another been impaired by the strain and stress. It is clear that if the effort to secure an adequate share of the nation's produce for the working community meets with resistance, we shall have a

period of great unrest, class conflicts, and strikes ; and if the nation's needs are great, as they will be, any resistance to these demands will have feeble success.

8. In considering this problem of the future state of our currency, it must be borne in mind that our modern banking system makes our currency much more fluid than it was a hundred years ago. Our cheque system, in effect, is equivalent to the free issue of paper currency by the banks. This has been frequently shown, and may be put succinctly in this form—that a bank is practically always ready to make credit advances to a merchant of proved respectability and solvency on the security of goods. It is perhaps not generally understood that the merchant is the banker's ally and guarantor, for one often hears complaints of the less generous treatment accorded by bankers to producers. The merchant takes the risk of the market, and it is his constant duty to liquidate stocks, unlike the manufacturer who is biased in favour of his cost of manufacture, even when the demand for his product has ceased through some new invention, change of fashion, or other cause. Now, whether the bank pays the merchant in paper notes of its own, as in former days, or by allowing him to draw cheques on a credit placed at his disposal in its books, as in modern times, the result on the circulation is

the same. In the first case the notes issued swell the circulating medium. In the second case the advance placed at the credit of the merchant being drawn upon, reappears as a deposit with the same or some other bank, and the net result is that the aggregate loans and deposits are still equal to one another. To that extent the circulation is expanded and a corresponding expansion in the value of commodities follows, checked only by such a rise in the rate of discount (the Bank Rate) as will cause liquidation and stimulate export abroad.

9. Before the war, our exchanges were regulated through the Bank of England, which was responsible for the stock of gold held in this country as the basis of our currency, and the import and export of gold were left as far as possible free. But even in times of peace this method was not always entirely successful, notwithstanding the loyal co-operation of the joint stock banks ; and the Bank of England was frequently compelled to enter the market and borrow funds which it did not need and did not intend to use, solely for the purpose of enforcing the official rate of discount. At the beginning of the war this system broke down, as it was bound to do, and the export of gold was, and still is, prohibited, as anyone who attempts to go abroad with gold in his possession will quickly ascertain. Thus, the exchanges

have for the last three years ceased to be controlled by gold shipments, the control now being secured by the flotation of loans as an offset to our purchases from other nations. This means of regulating the exchanges by the discount rate may well be continued after the war, but it can only be supplementary to the more effective method of fixing from time to time the gold equivalent of the pound sterling, and this can best be done by a Committee, or Commission especially appointed to examine into the nation's assets and liabilities. We shall thus be brought face to face with the question, as to whether and how we shall preserve a stock of gold, if we fail to equate our pound sterling with gold. If we do not wish to prohibit the export, we shall have to fix a new rate for the purchase, not £3 17s. 10 $\frac{1}{2}$ d. per oz. as formerly, but possibly £5 per oz., or some other figure representing our true financial position. Indeed, it is arguable that we should stand to benefit by ceasing to settle debts in gold, as our foreign customers would then be compelled to take our manufactures in exchange for our purchases from them, instead of taking precious metal, the transport of which, if not intended for commercial purposes, is purely wasteful.

10. If we attempted suddenly to bring back our values to their gold parity, the result would be disastrous to trade and industry by bringing

about an enormous fall in values, accompanied inevitably by tremendous depression and numerous failures. A rapid fall in values will always discourage production and thus cause unemployment, because no man will willingly create a supply of goods which are likely to result in a loss on sale. Unemployment diminishes the spending power of the community, and thus we are driven into a vicious circle in which conditions go from bad to worse ; and the very cause that would bring about these conditions, viz. the attempt suddenly to reinstate gold values, would increase the load of debt on the community, and intensify the misfortunes of the manufacturer, distributor and worker. The truth is that the restoration to gold parity can only be brought about by a gradual and natural process. As the debt is paid off the value of the pound sterling will improve automatically, and the quickest way to pay off the debt is clearly by stimulating the population to the fullest possible measure of activity. Any attempt to restore the purchasing power of the pound sterling by other means than by paying off the debt, as, for example, by a drastic rise in the rate of discount, would defeat the purpose aimed at. It would withdraw from industry the very funds that are needed to carry industry on. It would have a similar effect to the foreclosure of a mortgage, or a forced sale in a moneyless

market. Such a debt as we have incurred during the war can only be paid off through the energy, skill and application of our people, and cannot be paid off on short notice, however great our efforts, or however rapid the expansion in our population. Indeed, an artificial decline in trade would in itself check the growth of our population and delay the process of recovery. We need not expect an exhausting war of these dimensions to recur for some generations. As we pay off the loan its value will rise, and the rate of interest will fall, which will benefit the trading community ; and the money taken from the tax payer and reinvested by those who are repaid will certainly find its way back into new and fertilizing enterprises, and will keep our population healthily employed.

II. The process of paying off the cost of the war will obviously be greatly facilitated if the energies of the nation are properly directed into remunerative or constructive labours, such as will benefit the whole community, and strengthen it for competition abroad. It is an error to think that our population need be worse off through the war, once the great struggle comes to an end. History records that the country was very prosperous after the great plagues in England, when the loss of life was excessive. But we need not expect that we can revert to exactly the same conditions as before the war. Our

nation will not be able to indulge in so much luxury or idle sport. We shall need to devote our brains and activities to the creation of a much more compact and effective organization in every industry ; and it is time for us to realize that the Germans themselves are already preparing for a movement of this kind, by consolidating their principal trades into large trusts. We shall need to spend more money on education, on scientific research, in the encouragement of invention, and the exploitation of new territory, on the improvement of agriculture, and the housing, the health, and the condition of the people generally, in order to secure the best results. It is unavoidable that taxation should fall heavily upon property as distinguished from service. Where the services of all men are required to re-establish the health of the community, we shall be unable to encourage any diversion of the people's energies for the purpose of ministering to the extravagances of the wealthy. Large fortunes have been accumulated in this war, and it would be disastrous to us as a nation if they were used for purely selfish purposes. It would be a foolish conclusion to think that when peace comes all our efforts may cease, and we may sink back into our old easy-going methods. In the process of restoration we can afford to carry no passengers on the ship ; and every one

will have to pull his weight on the oar, if we are to overtake other nations in recovering from the financial losses of war. This alone is the strongest possible argument that can be offered against any attempt to put a premium on idleness or unproductive labour by attempting to force the value of money back to its old level before our debts are paid.

12. The suggestion here made therefore is that we shall set ourselves to work with all our energy to pay off these debts, and that we shall contemplate a gradual restoration of the pound sterling to its former gold equivalent, not by artificial or inadequate expedients, but by the simple and courageous method of paying off our debts. Even from a military point of view it was a disadvantage to us to start this war with a heavy burden of indebtedness inherited from the days of Napoleon the First, and the nation must for its own safety set itself to work with patience and perseverance to clear off every penny of the vast accumulation of debt that is now being contracted if it is to place itself in an unassailable position against the contingency of a future struggle like the present. In the century following the Napoleonic wars we were fortunate to have an enormous increase in population, and an unprecedented increase in their productivity, owing to the rapid extension in the application of the recently

invented steam engine, and the stimulus thus given to the genius and inventiveness of the race in every direction. This made it a comparatively simple matter to supply the produce called for by the owners of the National Debt ; and we were thus able to maintain our sovereign at its gold parity, though after Waterloo there were times of great distress, and Wellington himself may have realized how hardly the effort bore upon the people. It would, however, be folly to count on an equally striking development in the productivity of our people in the coming generations. But there is something to be hoped for in the great part our women have assumed in national life. They have shown their capacity to carry on in the absence of the men, and in this fact there is great promise that their co-operation in industrial life will be a valuable addition to the wealth production of this country, let us hope without the sacrifice of home life. The training in the habits of industry will have a far-reaching effect on the life of the nation, especially in those families where the daughters were formerly never given the opportunity to fit themselves for a life of useful service to their fellow creatures. We must not assume that this is really the last war. That is a delusion. War is as much a part of human life as the struggle for existence is in the plant or animal world. Who knows what great and

startling changes may take place in the world's constitution during the next hundred years? Who at the time of Trafalgar or Waterloo could have predicted the character and extent of the present struggle, or the marshalling and disposition of the contending forces?

13. The question of stabilizing our exchanges with the Colonies and Dependencies cannot be dealt with here, but it is obvious that they must share financially in the burden of Empire as they have done in a military sense, if they wish to maintain the old relations between their currencies and ours. Already a suggestion in this direction was put before the Imperial Mission Section of the Tariff Reform League last April by Sir Joseph Ward, the Finance Minister of New Zealand. The appointment of a Committee to consider the problems connected with the Currency is an important step in the right direction, and the future health of the whole trading community may depend on the conclusions at which they arrive.

APPENDIX II

MEMORANDUM SUBMITTED BY THE AUTHOR TO THE "MACMILLAN COMMITTEE" ON FINANCE AND INDUSTRY

1. THE War brought about an immense increase in the documents of title which establish a claim on production. This increase took the form, not merely of currency notes unbacked by gold but in an increase of the British national debt far beyond all previous imaginings.

2. To the Cunliffe Committee towards the end of the war was referred the question of how we were to return to the gold standard. That body consisted mainly of bankers, and the question was considered almost purely from the banker's point of view. The effect of the huge increase of paper liabilities that did not take the form of circulating medium was not brought under consideration as a possible source of disturbance to the policy outlined.

3. In 1917, while the Committee was still sitting, the writer perceived that this great mass of unproductive debt (i.e. liabilities incurred with-

out any increase of production to compensate them) constituted a most serious obstacle to our return to the pre-war rate of exchange with the dollar or gold, and issued a warning early in 1918 in the form of a memorandum of which we submit a typewritten copy. The analysis of the situation makes interesting reading now, but attention is directed especially to paragraph 10. Had the procedure there outlined been adopted, British industry would have been relieved of the terrible strain under which it has laboured for the last twelve years. Our wealth would have increased, and the loss of some 3,000 million working hours of our industrial population would have been converted into profitable production.

4. As a remedy for the conditions foreseen, the writer proceeded strongly to advocate the establishment of a new and more scientific standard of value. The Cunliffe Committee had themselves shown that the Bank of England maintains parity between the pound sterling and gold by the Bank rate and its market operations. In effect, the currency and credit system of Great Britain before the war was controlled not by a holding of gold proportionate to the vast turnover of Britain's national and international trade but by the Bank's skilful management of the discount market. A stock of gold of only about £30 millions, a derisory figure compared to the huge stores now held in the United States

and France, was considered an ample margin to work upon.

5. It was clear that we could control the value of our currency to conform with a commodity like gold, varying greatly in supply and in the cost of production, and subject to the eager competition of other nations to secure it in bulk against the eventuality of war, while appealing strongly to the hoarding instinct of primitive peoples.

It was even clear that we could so control the value of our currency as to improve its relation to gold, which, in fact, was the problem to which the Cunliffe Committee directed its attention. The object of a gold currency is declaredly to secure stability of values, and especially stability as measured by the great international produce markets which are the real currency of commerce, and the greatest influence on the exchanges. Clearly, if the gold link fails us, there is nothing to prevent the functioning of our banking system in favour of a stable level of values as tested by an aggregate of those vital products, the food and raw materials that are the basis of our existence. The business world, indeed, has found it almost impossible to control its operations without reference to numerous Index numbers, such as those of the *Statist*, *Economist*, *Times*, *Financial Times*, Bradstreet, etc., etc. England, the great centre of

international trade, with markets daily regulating the value of the products of every nation, has in its hands the power to make the pound sterling the symbol of stability for the whole world, if she wills it.

6. The Cunliffe Committee were asked the question, "How are we to get back to the gold standard?" and they answered it, in practically one word—"Deflation." They did not warn us that deflation must be applied not merely to the paper in circulation but equally to our immense paper liabilities bearing interest, and failing that, that there would be a progressively increasing proportion of the nation's production absorbed by non-producers (as now shown by Sir Henry Strakosch), thus aggravating the cost of production for the producers, destroying their trade, increasing unemployment and still further augmenting the number of non-producers. Can anyone at the present moment guarantee that the downward tendency of international values will not continue? There is still no indication of a lessening in the demand for gold. It is quoted at a premium in London to-day. In Australia and New Zealand and in the South American States it stands at a fairly heavy premium. How then shall we bear the further increase in our unproductive liabilities that will ensue with a further rise in the value of gold?

7. This fact becomes obvious : that our return to the gold standard on sound economic lines would always be conditioned by our regulating uniformly to the value of gold all those items of cost that enter into the nation's business Balance Sheet. Yet we exclude from the operation of the gold standard a vast mass of values which are each year absorbing an increasing share of the nation's production and are thus reducing the volume and raising the cost of our exportable surplus.

The values excluded from the operation of gold are mainly :

- (1) The National Debt.
- (2) The Social Services.
- (3) Education.
- (4) Unemployment and other benefits.
- (5) Fixed Interest bearing loans, mortgages, debentures, etc.
- (6) The Wage-Level.
- (7) Professional Fees.

These create an appearance of welfare in some quarters and especially in the Southern Counties, which is not borne out by the actual state of trade, the condition of the great Northern Industrial areas, or the profits of enterprise. We include the wage-level for a very definite reason. A fixed unemployment wage tends to stabilize all wages at a fixed figure, even without the operation of trade boards or the resistance

of the trade unions to change, and thus wages tend to be settled without reference to the international level of gold prices.

8. This fact may be very saliently expressed in the following way. Let us imagine a State which decides to have a currency based, not on gold, but on an equal wage at all times for the same labour—in other words, a “labour unit,” not a “gold unit.” In the working of such a standard, the credit system would be expanded until the surplus of labour was absorbed up to that margin which is prudent to keep for the sake of efficiency and the needs of new or expanding industries. Such a standard would be perfectly feasible, but there are objections to it which cannot be discussed here and it could never become an international standard. The same procedure must be adopted as in the case of gold ; a fixed price for labour and the absorption of all the surplus that is offered at the fixed price. The procedure is now normal with us. We are prepared to absorb the whole surplus of labour at a fixed and fairly generous price. The people of the United States many years ago adopted the same principle in the case of silver at a time when bimetallism was looked upon by many as a feasible policy. The result may be imagined. The unwanted surplus of silver grew to such alarming proportions that purchases had to cease and the consequences were disastrous.

Our own policy cannot be more successful, although carried out on a more heroic scale, and it becomes still more dangerous when, included with it, we have so huge a volume of public expenditure excluded from the operation of deflation.

9. It now becomes clear how France, who suffered far more heavily than we in the Great War, both from loss of life and the devastation of an important section of her territory, has not suffered from the devastation of peace as we have.

France to-day is far more truly on the gold basis than we. Her debts have been scaled down to figures which are well within the capacity of the national industry. Wages and cost of living are on the pre-war gold level, while ours stand nearly 60-70 per cent higher, and the consequence is inevitable. France is a magnet for gold because gold will go where it receives the best service. Even her Bank rate of 2 per cent does not repel it. Every other nation, except ourselves, has *deflated its debt*, either by writing down the value of its currency, as in the case of the other European belligerents (whether victors or vanquished), or, as in the United States, by substantial reductions of a debt which, from the start, was much lighter per head than our own. The service of our debt costs practically the same in 1930 as it did in 1920.

The real weight is, of course, far more serious, and continues to grow while we are at the present moment incurring fresh debts for unproductive purposes, such as the unemployment fund.

10. *To conclude.* Our return to the pre-war gold standard has been made without due regard to all its implications, or an adequate survey of the circumstances. We have wrecked our great industries in the process, and it is doubtful if we can regain much that we have lost. A very great deal is at stake, not merely industry, but our financial power as well, our ability to uphold the Empire, and our military and naval power which, in the last analysis, is bound up with the strength of our industries. A clear-cut decision is needed. We may before long have to face a break with gold, simply because the strain has become intolerable, while there is nothing to prevent its becoming even worse.

11. If we retain gold as a measure of values, every value that we deal in must move in conformity, our national expenditure must be well-nigh halved, and the whole of the system of doles and benefits must be radically revised, and even then we must take steps to restrain international competition for the gold supply. If these measures seem too drastic, we have only one alternative : to break with gold and declare that the British currency will in future represent

an equal purchasing power in the great international products, and that gold will no longer be bought or tendered at a fixed price. Such a declaration would be an effective answer to the modern gold hoarders of whom the United States, who obstruct the import of our products and insist on gold in exchange, are by no means least blameworthy. The machinery of the exchanges would adapt itself to the change with far more ease than enabled us to handle the vastly more difficult post-war exchange chaos. The Bank of England would not be forced in a period of bad trade to increase its discount rate in a fresh onset of deflation, and thus to aggravate the woes of the industrial community. Buyers and sellers, debtors and creditors, bond-holders, preference and ordinary stock holders, would know that the scales were held equitably between them, and that price had a definite meaning not attachable to the vagaries of gold. England, with a currency consisting of the very articles that we trade in most freely, would find no hindrance to the payment of her debts.

12. The abandonment of free trade, which is now receiving increasing support in all quarters, is, in effect, a confession of defeat, of our failure to adjust ourselves to gold ; and the purpose of the new orientation may be declared to be that of dissociating national values from the international (or gold) price-level. That policy may

succeed in its aim. We shall be more self-contained. What we lose in international trade, we shall gain in working for ourselves. But our status, as a great international emporium, will by that degree be diminished. It is, in effect, a weak substitute for the strong policy of reconstructing our whole economic system in favour of equality of treatment to every constituent of production ; labour, capital, management, and not least enterprise, and that equality of treatment will never be secured until the most important element in all contracts, the price, is a guarantee of stability and fair play.

13. The present state of England exhibits many of the signs that betrayed ancient Rome, the high standard of living, which agriculture and industry were unable to make good in the markets of the world, the growth in the numbers of officials, the multiplication of the unfit at the expense of the fit, the efforts to maintain an unsound economic structure by excessive taxation, and the liberal distribution of doles. No committee that has been appointed since the war has been charged with a more important mission. It *may save Britain* and its Empire.

14. The sum of the matter seems to be this : that England blundered profoundly in assuming that the question of a return to the gold standard and the terms of that return was purely a banking question. Our action was premature,

and had no relation to the huge commitments we had undertaken in debt and social services. We sacrificed industry to finance, forgetting that finance is the child of industry. Our pride in victory deceived us, and the crisis which every belligerent in Europe but ourselves has undergone, has still to be faced by us. That crisis has been brought appreciably nearer by the recent sharp improvements in the value of gold as measured in those commodities that bulk most largely in the international trade of the world, and it would be like the act of a foolish gambler holding stock on a falling market, to assume that the fall of values due to the appreciation of gold, has ended. The evidence of statisticians is strongly against such an assumption. Gold is in far greater demand than before the war for currency and banking purposes, and there are no fresh sources of supply of the metal in sight. The Transvaal, which furnishes about half the world's needs, is not an inexhaustible field.

15. England has prospered in the past by leading the world. She must lead still, and her leadership can best be exercised by placing her whole economic system above the dominance of any one metal or article. We set the fashion in gold, and the whole world followed, to our undoing. Like leaders of fashion, we must lead in a new direction, and that direction can only be towards a sounder and more scientific measure

of value. It is due to the age of science in which we live.

16. No Scientist would tolerate an elastic yard or a fluctuating ounce. We prescribe the metal, the temperature, even the barometric pressure, in which our yard is to be measured, but we leave the most vital measurement of all to the accidents of fortune, and our very future is compromised. As to the question whether such a standard is feasible, the Committee have only to take evidence. The writer, with a practical experience of over thirty years in the City of London, which includes very considerable dealings in the Exchanges, is satisfied that there is no obstacle, practical or theoretical, to the achievement of the end desired. The Bank of England which, with difficulty, equates our values to the erratic movements of the yellow metal, could, with far less difficulty, equate them to secure at all times to all holders of the pound sterling an equal purchasing power in the world's great produce markets. There would be far less chance of the breakdown of its control than there has been in the past, and it would be in the common interest of every section of society, of labour, of capital, and of enterprise, to uphold its power for their own security.

17. The legalization of such a standard presents no difficulty whatever.

SUMMARY OF POINTS FOR THE COMMITTEE

1. The cardinal defect in the report of the Cunliffe Committee was the assumption that the centre of gravity of the British economic system would remain unaffected by the prodigious debts incurred during the war, and that a return to the gold standard was merely a question of monetary deflation.

2. In the last analysis, the burden of debt has to be met out of the productive resources and labour of the nation, which are generally now summarized roughly under the heading of "Industry."

3. Every other nation but ourselves has either devalued its currencies and thus reduced its debts to correspond with the ability of its industrial structure to meet them, or, like the United States, has vastly increased its industrial resources, and simultaneously cut down its debt. The United States debt has fallen in this way from 240 dollars per head of population in 1919 to 140 dollars in 1929. Our debt remains substantially as it was, but in real weight is at least fifty per cent greater.

4. Our return to the pre-war rate of exchange with gold has therefore subjected our economic system to a strain which may before long lead to consequences far more serious than any that have yet appeared.

5. That strain has been aggravated by certain causes, chief among which may be cited—

- (a) The adoption of the gold standard by practically every other nation in the world, a condition of things which is new to history and which has immensely increased the competition for any free supplies of gold.
- (b) The tariff barriers that have been erected throughout Europe and, still worse, in the United States of America which in effect put a heavy premium on gold as a means of settling debts.
- (c) The practice of the Federal Reserve Board of the United States in holding stocks of gold far in excess of the needs of their banking system.
- (d) The low value fixed for certain post-war currencies and especially the franc, which has enabled the countries so placed to stabilize at practically the pre-war level of values and thus to draw gold strongly into their coffers, as France is doing.
- (e) The unrest in India and elsewhere which encourages the hoarding of precious metals in preference to investment in securities. Witness the decline in Indian securities.
- (f) The demand for gold in connection with reparations.

6. In considering the internal working of the gold standard it becomes obvious that it fails to function efficiently under a system by which a large section of our economic activities is stabilized without reference to gold. Wages, as administered by trade boards and trade unions, debt, social services, unemployment pay, pensions, etc., constitute one standard of measurement in large part immutable, while the products of industry generally, except in the sheltered trades, are valued by reference to gold. The former thus exact an increasing toll on the nation's output, leaving a continually smaller surplus available for the outside markets at an enhanced and therefore increasingly unmarketable price.

7. As long as gold remains an alternative form of payment to the products of the nations, the money illusion will remain and the free exchange of products will be obstructed, as it is now even by the most enlightened races ; the sense that *money* means *power* will prevail over all more rational considerations and the international rivalries that are the seed-bed of war will be fostered. Our own Free Trade principles cannot stand under the strain of present developments and are fast breaking down.

8. A break with the gold standard, as established in 1925, seems therefore inevitable unless Britain is content to lose her financial and

industrial power and to be overwhelmed by a gradually but steadily increasing load of debt, of which there are grave symptoms now. Such a disaster will accelerate the break-up of our Imperial connection and will leave us much in the condition of Spain after the loss of her colonies.

9. The situation can be saved from the moment it is realized that there is no magic in gold or the gold standard. England, who has led the world so far and who, in Pitt's phrase, "Saved Europe by her exertions, and can save it by her example," can confer on the world the greatest boon of all time, a scientific standard of measurement for values, and it is only by concentrating on this aspect of the matter that a solution of our present difficulties can be expected.

10. The pound sterling must be made the symbol of stability, not a mere piece of metal subject to the vicissitudes of the mining industry and the caprices of a world which attaches a kind of superstitious reverence to this particular metal and buries it out of sight and utility in immense quantities.

11. The powers now possessed and wielded by the Bank of England are just as available to maintain stability of the price-level as they are to maintain parity with the erratic movements of gold. The same machinery will function, but with greater simplicity as the world will better

understand its operation. The trade and employment of the whole world would tend to be stabilized in a way that has hitherto been impossible.

12. We have learnt that the actual handling of gold is not necessary to a sound banking system and that the Bank of England can perform its duties without paying out sovereigns. The time is therefore ripe to consider whether a sounder unit can be put in the place of this metal, and England has the unique advantage of being the centre of the world's commerce and therefore able to link its currency and credit system direct to the great basic products which form the real circulating medium of international trade.

13. All the means by which this could be achieved are in our hands ; the Banking mechanism and its control by the Bank of England, the Exchanges, the produce markets and money market where values are brought to the hourly test of actual dealing, the indexes of price fluctuation compiled by numerous observers, the world survey of trade conditions that is accessible to every man or woman in the City of London. Nowhere else in the world are the conditions more ideal for the step which may save Britain from economic extinction and will lift the world on to a new plane of economic and social progress.

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